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# Legalseas

**Topical issues and law reforms in the shipping sector**

Issue 25 / November 2014

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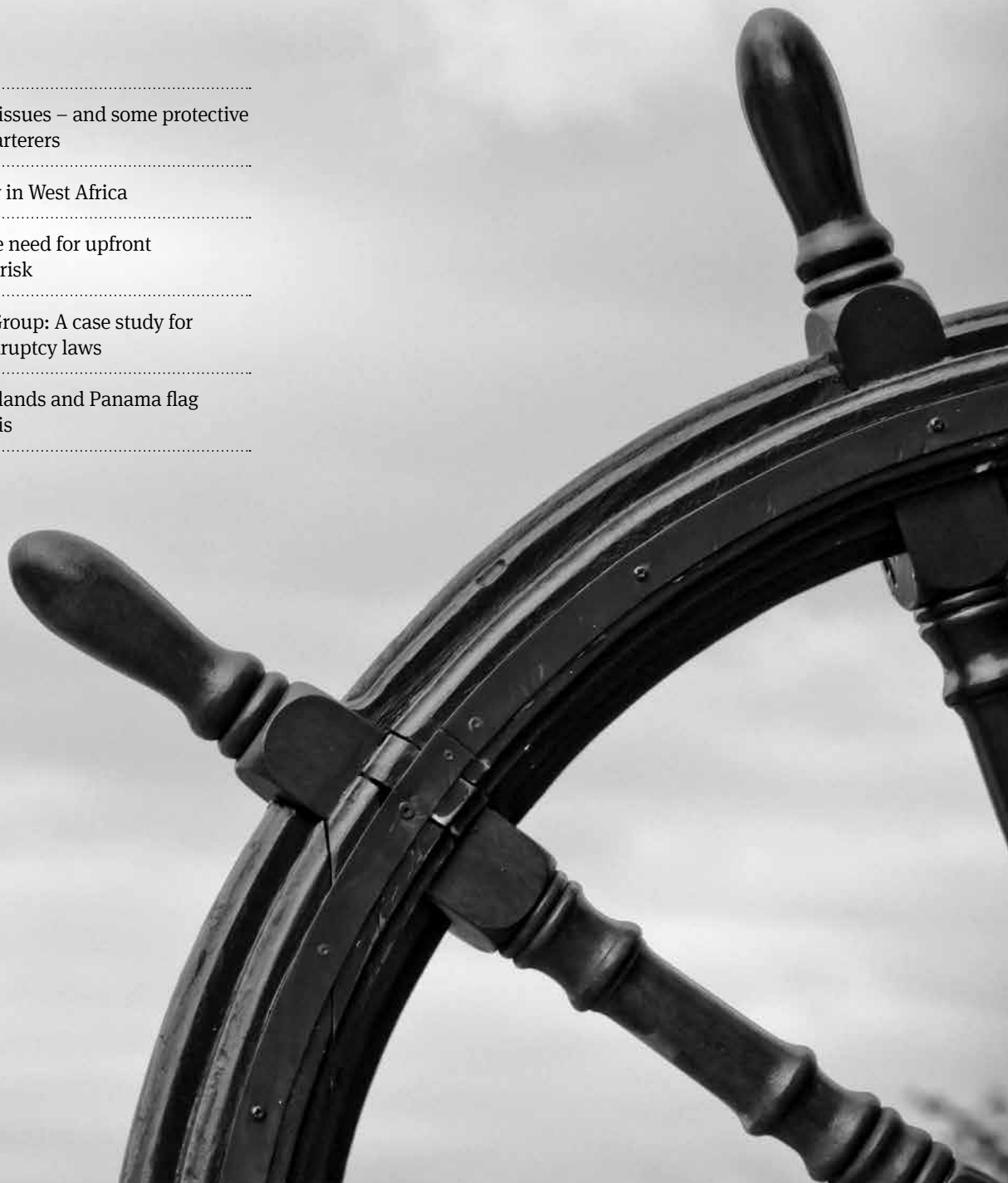
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# Introduction

## Welcome to our autumn edition of *Legalseas*!

Welcome to the autumn edition of *Legalseas*. We open this edition with an article from Durban partner Andrew Robinson, and Melbourne partner Hazel Brasington on the topical issue of Ebola. Andrew and Hazel offer some legal and practical guidance for vessel operators in response to this evolving risk.

Keeping with the Africa theme, our second article from London partner Philip Roche, and senior associate Holly Stebbing, looks at piracy in West Africa. While piracy attacks in the Gulf of Aden are falling, they are on the rise in West Africa and Philip and Holly consider whether lessons can be learned by those operating in West Africa from the approach taken in East Africa.

In our third article Hong Kong partner Marc Waha, London partner Ian Giles and senior associate Mark Daniels look at different anti-trust regulatory regimes and the different approaches taken by the regulatory authorities in relation to the proposed P3 and 2M shipping alliances.

Moving across to the US for our fourth article, Dallas partners Louis Strubeck and Kristian Gluck look at Overseas Shipholding Group as a case study for the effective use of US bankruptcy laws.

Our next article from partner Jonathan Silver, who recently joined us in Hong Kong, provides a comparative analysis of the rules and regulations governing the flags of Hong Kong, the Marshall Islands and Panama in the context of ship financing.

Finally, our case updater in this edition from London associates Emma Humphries and Emma Burrage, looks at the case of Michael Hirtenstein, *Il Sole Limited v Hill Dickinson LLP* [2014] EWHC 2711 (Comm) and the judicial interpretation of 'as is-where is' in the context of a sale of a second-hand yacht, and whether these words are sufficient to exclude the implied terms as to satisfactory quality.

As always, we would be pleased to receive any comments from you on the content (including editorial) and style of *Legalseas* and any suggestions of future topics that you would like to see covered, by using the [feedback email address](#).

Please also feel free to send us the details of your colleagues and contacts who may wish to receive *Legalseas*.

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# Ebola virus

## Mutating issues – and some protective gear for owners and charterers

As the West African Ebola virus outbreaks remain uncontrolled, even operators not serving West African routes are now seeking guidance on protective clauses. Clearer information has emerged on some aspects, but responses from officials and from individuals who are in fear of the disease continue to complicate the picture.

For operators, who are charterers, and shippers trading to affected African ports, a key question is whether conditions at ports within a known outbreak area pose an actual serious risk to the safety of the vessel and crew. It is only a matter of time until some of the special liberties and indemnities that are being incorporated into charterparties, bills of lading and purchase and sale agreements are tested in arbitration or court proceedings.

In charterparties, clauses closely modelled on ‘war risk’ provisions are in use. They are likely to be effective in voyage or time charterparties, if a port is closed so that it is impossible or unlawful to enter. If a port is closed after nomination, an analysis of the contract provisions will be needed to determine the parties’ rights and options. Separate obligations under sale contracts and bills of lading must of course be considered too. A time charterer must continue to give valid orders for the vessel’s employment, while a valid nomination under a voyage charter fulfils, and brings to an end, the charterer’s choice. In a voyage

charterparty context, shipowners may prefer to fix on ‘port’ rather than ‘berth’ charterparty terms, to be able to tender a notice of readiness at anchorage if there are local difficulties.

As to the prospective unsafety of a port, objective proof of actual serious risk to the crew or the vessel may be a challenging task, not only because it is hard to source reliable data where medical and administrative infrastructure is lacking, but also because expert opinion would take account of known means of avoiding the hazard by restricting access, tightening up on anti-stowaway procedures, using protective clothing and implementing hygiene procedures. Arguably, good shipboard management in this context is akin to ‘good seamanship’ for purposes of the well-established legal test of the safety of a port<sup>1</sup>. Protocols and industry practices for the prevention of infection are gaining more consensus and are being well publicised (including in P&I Club publications) so that there is less room

for argument that these matters call for more than ordinary skill<sup>2</sup>.

Not to be forgotten, it is ships’ crew who are on the front line. Managing the legitimate fears and expectations of crew would certainly be assisted by some public industry-wide consensus on appropriate shipboard management protocols. Building confidence among seafarers and port personnel can only assist to reduce instances of shore personnel refusing to board, or crew refusing shore contact or refusing to leave the vessel for necessary operational purposes.

Paying ‘danger money’ to local officials raises ethical concerns, particularly where companies or individuals are subject to the United Kingdom’s Bribery Act, or other legislation where facilitation payments are proscribed and no defences are available. Obtaining a record of published port tariffs and avoiding payment to individuals is therefore advisable.

Until there are positive signs of the Ebola virus epidemic running its course or being successfully contained, events may prove too unpredictable to avoid a dispute. For example, it was reported on October 20, 2014 that WHO officially declared Nigeria to be free of Ebola virus transmission – on the basis of no new outbreaks for 42 days. Beyond October 20, 2014 however,

<sup>1</sup> *Leeds Shipping v Bunge (The Eastern City)* [1958] 2 LLR 127

<sup>2</sup> *Kristiansands Tankrederie A/S v Standard Tankers (Bahamas) Ltd (The Polyglory)* [1977] 2 LLR 353

*continued* ▶

port control measures remain in force in Nigeria. In this situation, clauses that use definitions like 'Affected Area' that are based on a World Health Organisation declared status for a region or country may fail to trigger the liberties or indemnities that operators were hoping would protect them. Circumstances could, of course, change again without warning in response to situation reports that are made on a daily basis by WHO.

Coincidentally, on the day of writing this article, news came through that one of Africa's busiest ports, Durban, (South Africa being a non-Ebola affected African country) had closed for a short time, while port authorities conferred with all its pilots on new developments relating to the Ebola threat. Ms Lynne Brown the Minister for Public Enterprises of South Africa, has also responded to questions in parliament about current measures in place at eight of South Africa's main commercial ports (Richards Bay, Durban, East London, Ngqura, Port Elizabeth, Mossel Bay, Cape Town, and Saldanha). Brown said that 'the West African states of Guinea, Liberia, and Sierra Leone were rated as high-risk to the Ebola exposure, while Nigeria, Kenya, and Ethiopia were rated medium-risk.' She confirmed that all vessels arriving from designated countries 'are required to be stringently screened by port health officials at anchor, prior to the vessels entering into any South African commercial port'.

The ports authority is a division of Transnet, and manages all the main South African ports. Attention has lately shifted from the ports located in outbreak countries to subsequent ports of call. It is here that new and rapidly changing port requirements are likely to be seen. For example, if a sanitation certificate is required in connection with previous port calls, the scope of the certificate may suddenly become more extensive so that it cannot be complied with retrospectively.

Alternatively, additional crew movement history enquiries may be required and may extend the time spent waiting at port – and potentially also spent 'off hire'. Traders who run commodities into West Africa on a regular basis on long term agreements with customers, are faced with the possibility that the load port authorities may require ships that have sailed from West African ports to wait at the non-Ebola affected load port for 14 days before declaring Free Pratique and allowing the ship to enter to load. Apart from the spectre of a large demurrage bill, the delay can cause havoc with production schedules and storage space.

When considering the best clauses to use, some difficulties can be avoided. On our list of things that can cause concern are:

- wording that requires a party to prove circumstances for which evidence will be almost impossible to collect
- clauses that could fail to operate when some other event intervenes following an Ebola related circumstance (for example the cause of delay is another affected vessel in a queue)
- sale contracts that are not updated to reflect vessel demurrage exceptions and vessel related costs to be passed on.

### Final thought

The Ebola virus is relatively difficult to catch, not being airborne – compared to say tuberculosis or SARS, and the available authoritative medical sources indicate that infection can be prevented by thorough implementation of precautions. The risk of claims and disputes under charterparties, sale contracts and bills of lading is, by contrast, disproportionately high.

This is the result of a combination of the deep and justified fear of the disease, as well as of the inconsistent and constantly changing regulatory responses. The best 'protective gear' for vessel operators of all kinds includes staying closely attuned to new developments, taking account of expert guidance as it evolves, and being prepared to revisit shipboard practices and contract terms as frequently as the changing circumstances require.

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# East meets West? Piracy in West Africa

In 2007 the Gulf of Aden, one of the world's busiest sea lanes, became the scene of numerous attacks by Somali pirates. Following a robust and coordinated multinational response, together with a good degree of 'self-help', notably the placing of armed security teams onboard transiting ships, attacks in this region have decreased significantly since 2012. However, in West Africa piracy attacks have increased by 210 per cent since 2011 and show no signs of abating.

What, if anything, can operators in the Gulf of Guinea learn from the experiences from East Africa and why is the situation so different?

## Piracy in the Gulf of Aden

The lack of effective governance in Somalia meant that there was no local governmental control to prevent piracy attacks. But the upside to Somalia's 'failed state' status was that the international community had the freedom to implement targeted measures to tackle the pirates in Somali waters. The shipping community and international naval forces became involved in finding a solution – best management practices were issued to ships (BMP4 being current) advising on how to harden and defend the ship and co-ordination of the naval effort was organised by the EU and others through the Maritime Security Centre (Horn of Africa), or MSC(HOA) as it came to be known.

Importantly, most of the piracy in the high risk area took place on the High Seas and ship operators were free, subject only to flag state concerns and practicalities, to take whatever measures they thought fit, including deploying armed security detachments through good quality Private Maritime Security Companies (PMSC). When the use of armed guards demonstrated its effectiveness, without any appreciable downside, then most flag states amended their rules to permit this practice. The result of these combined efforts is that piracy has been effectively suppressed (although not eradicated) with no ships being hijacked in 2014.

So if this approach has worked off the coast of East Africa, why has it not worked in West Africa where hijackings and attacks are commonplace and increasing?

## Piracy in West Africa

West African piracy has been on the rise since late 2010 and the threat seems to be spreading from Nigeria to other countries including Togo, Gabon, Ghana and Angola.

Whereas vessels attacked in the Gulf of Aden and Indian ocean were largely on passage through the area, the Gulf of Guinea is more than just a trade route; it has a number of busy domestic ports and is the hub of Africa's offshore oil and gas industry. The coastline is consequently littered with vulnerable targets; vessels at anchor waiting to discharge or load cargoes, often by STS, offshore supply boats with low freeboards manoeuvring slowly; oil platforms and so on. The main targets for West African pirates are tankers carrying high-value refined petroleum cargoes, which can then be stolen and resold onto the active 'petroleum black market'. Since 2010 it is estimated that '117,000 mt of product worth approximately US\$100 million has been stolen in the Gulf of Guinea'<sup>1</sup>.

<sup>1</sup> [http://www.riskintelligence.eu/maritime/gulf\\_of\\_guinea\\_tanker\\_hijacking\\_report/](http://www.riskintelligence.eu/maritime/gulf_of_guinea_tanker_hijacking_report/)

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More recently, hijackers have also started attacking vessels and kidnapping crew for ransoms, no doubt recognising the potential to extort millions of dollars from operators. Attacks are carried out by highly organised criminal organisations with sophisticated intelligence networks and alleged political, military and industry links to the black market. Pirates are equipped with proper seagoing vessels, can obtain tankers to remove large parcels of cargo and have good knowledge of ship systems, particularly relating to communications. Reports of extreme and random violence against crew abound.

Most hijackings in West Africa take place in territorial waters, which means that the law of the sovereign state applies. Unlike Somalia, where there was no operating rule of law, the Gulf of Guinea states have established legal systems, their own coast guards, police and military forces. Whilst this may seem preferable to the lawlessness of the seas off Somalia, this has not proven to be the case. Those seeking to counter the piracy threat are subject to the complex regional politics in West Africa, fierce protection by these states of their territorial waters and sovereignty, under-resourced naval and coastguard forces, ineffectual legal systems and endemic corruption. The response from the Gulf of Guinea states has been slow-moving and there is a perceived lack of political will to address the issue even though regional agreements have been reached. Whilst these countries have notionally agreed to a multi-national framework for regional counter-piracy, there is distrust between the member states and this has hindered policy development. Hot pursuit is difficult and effective cross border operations under-developed.

This combination of factors, coupled with the growing sophistication of the pirates, has made controlling this

piracy difficult. The anti-piracy effort is not well co-ordinated, there being no real equivalent to MSC(HOA) in West Africa, and there is no question of a multi-national naval force being deployed to assist. Many of the BMP4 precautions are less effective in ships conducting STS or are required to remain stationary for long periods and this is reflected in additional guidance issued by the IMO to be read in conjunction with BMP4. But the chief impediment is the refusal of these sovereign states to allow private armed security onboard.

One of the key factors in driving down piracy in the Gulf of Aden was the use of marine security companies with armed personnel employed on, for instance, the BIMCO GUARDCON form. However, unamended it is not suitable for use in West Africa, where marine security companies can only operate with armed personnel provided by littoral states (Local Security Personnel or LSP) such as a detachment of armed police or coastguards. These guards are bound by their own military and local laws, which may conflict with GUARDCON and the company's operating procedures.

Combined with the varying quality and expertise of local guards, this has led to liability and insurance concerns for shipowners and, importantly, PMSCs only agree to use best endeavours to procure that LSPs obey the orders of the master and they do not warrant that the LSP will act with reasonable skill and care. Despite this, the use of only the best quality and experienced PMSCs who know which LSPs are reliable and effective is essential and must be combined with the best possible risk assessment. Insurers should be closely consulted with before operations in these dangerous waters which is reflected by the Gulf of Guinea being a listed area by the London Joint War Committee meaning additional

insurance premiums are payable to operate in such areas.

In many respects therefore, shipowners and charterers are more exposed in West Africa than they ever were in the Gulf of Aden: their vessels are operating in and remain in territorial waters rather than just passing through which makes them vulnerable to attack; pirates are increasingly sophisticated and have a reputation for extreme violence; there is a lack of effective regional engagement and any international response is hindered by the littoral states' unbending protection of their territorial sovereignty; and it is harder for vessels to defend themselves with the prohibition on the use of armed guards. Shipowners and operators must employ high quality PMSCs, conduct thorough risk assessment and ensure that their charterparties have robust piracy clauses protecting them in circumstances where pirate attacks occur.

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# P3 and 2M illustrate the need for upfront assessment of antitrust risk

Recent plans to increase cooperation in the liner shipping sector in the form of the proposed P3 and 2M shipping alliances have struggled to get off the ground because they raised concerns with some – but not all – competition authorities. The lack of uniform treatment has been driven largely by the different regulatory regimes that apply worldwide. These cases demonstrate the importance for dealmakers to undertake a detailed antitrust risk assessment at an early stage.

## P3 alliance

The P3 alliance – between Maersk, MSC and CMA CGM – was abandoned in June when China’s competition authority, the Ministry of Commerce (MOFCOM), blocked the arrangement on competition grounds. This was despite P3 having already been cleared by both the European Commission (Commission) and the US shipping regulator, the Federal Maritime Commission (FMC), albeit with the FMC imposing certain supply restrictions.

Some industry players criticised MOFCOM’s decision to prohibit the alliance alleging it was based not so much on competition concerns as on a desire to protect and preserve the market position of the Chinese state-owned shipping lines. Such criticism must be viewed in the context that this is the first time that MOFCOM has blocked a global foreign-to-foreign deal. MOFCOM identified its main competition concern as being that the combined share of capacity of the

three parties on the Asia-Europe trade (46.7 per cent) would significantly exceed their rivals and substantially increase their control of the market, with the next largest competitor having less than 10.9 per cent. Also key for MOFCOM was that P3 involved much closer co-operation than traditional shipping alliances, with collaboration on operational procedures, slot sales and service suspension decisions, as well as cost-sharing.

In fact, the differing outcomes for P3 in the EU and US compared to China are largely explained by differences in the relevant regulatory regimes or geographic markets considered in each review. In the US the FMC looked at US trades, where P3’s market share and strength was expected to be much lower than the Asia-Europe trades that raised concerns for MOFCOM.

The merger control rules in most jurisdictions – including the Commission’s overarching regime for the EU – only require notification and

formal approvals for ‘structural’ joint ventures akin to a merger (so-called ‘full-function’ joint ventures). This means looser forms of cooperation, like P3, fall to be self-assessed by parties for compliance with the general competition rules in most jurisdictions. China is one of the exceptions to the rule as even looser types of joint ventures can require merger approvals under China’s rules.

This difference in procedure was a significant factor in the EU and Chinese decisions, both of which focused on the competitive impact on Asia-Europe trades. The Commission’s ‘clearance’ was not a formal once-and-for-all approval, but simply a decision that the proposed P3 alliance did not raise any immediate competition concerns. In contrast, because P3 was caught by China’s merger control rules, MOFCOM had to reach a formal decision on whether to clear or prohibit P3 within a defined time period. Given these circumstances, it is perhaps not unsurprising that MOFCOM should have adopted a more cautious approach and taken the decision to prohibit the alliance.

MOFCOM’s decision had also raised suspicions because the parties were not able to offer any remedies that alleviated MOFCOM’s concerns, suggesting a prohibition decision was inevitable. Within a matter of weeks of P3 being blocked, Maersk and MSC had jettisoned CMA CGM and launched a more traditional vessel-pooling arrangement, 2M.

## 2M alliance

Having not intervened against P3, it appears unlikely the FMC or Commission would seek to prohibit the less integrated 2M with its smaller market presence. However, recent reports suggest that the parties are currently seeking to dissuade the FMC from ‘stopping-the-clock’ on its review while it awaits further information from them, potentially jeopardising 2M’s launch date. There have also been suggestions that the FMC is keen to discuss the deal with Chinese regulators.

While China’s regulators might also be expected to have fewer concerns than before, this is not a certainty. Interestingly, although China’s merger rules can capture looser joint ventures, Maersk and MSC are confident that 2M is a sufficiently informal arrangement to fall outside Chinese merger control, having cast adrift P3’s proposed jointly-owned LLP.

However, even if not subject to MOFCOM’s jurisdiction for merger review, 2M has had to be filed with China’s Ministry of Transport (CMoT) – which is the approach that has been adopted by previous ‘traditional’ vessel sharing arrangements. No such vessel sharing arrangement has been prohibited by China’s authorities to date, which might be read as suggesting that 2M should be cleared unless the details of the proposal raise any novel issues.

However, 2M is not guaranteed to escape a Chinese competition review as CMoT has the ability to investigate whether certain shipping alliances harm competition. Significantly, 2M’s share on the Asia-Europe trade is reportedly 36 per cent – and therefore above the 30 per cent threshold at which CMoT can investigate competition concerns, and higher than has been the case in previous arrangements that CMoT has considered.

While a 36 per cent share is not overly high from a standard antitrust analysis perspective, if CMoT were to launch such an investigation this may again fuel suspicions that Chinese regulatory decisions are being driven by Chinese protectionism. However, an investigation could be in sight given recent suggestions in China’s media that MOFCOM views 2M as a ‘monopoly’ notwithstanding the absence of CMA CGM. Similarly, China’s state broadcaster has already suggested that 2M could pose ‘great challenges’ to China’s state-owned shipping lines and raise prices for consumers.

## Comment

Whatever the ultimate outcome for 2M, these cases demonstrate the importance of considering competition issues at an early stage in any proposed shipping cooperation arrangements. The latest proposed alliance – Ocean Three – between CMA CGM, China Shipping Container Lines and United Arab Shipping, will no doubt need to navigate the same regulatory obstacles. The uncertainty and complexity created by the differing procedural frameworks, timelines and legal tests in the multitude of potentially relevant jurisdictions creates challenges which need to be addressed head-on, and mean that competition reviews need to be factored into deal timelines and overall risk assessments.

There are over one hundred jurisdictions which now have competition laws to review transactions. For a necessarily international industry such as shipping – and one that is vital to enable world trade – many industry insiders have called for a single global regime to replace the current legal mishmash. While this may be desirable from a global policy perspective, it is highly unlikely in practice. The days of liner conferences, under which rate and capacity fixing agreements were permitted in order to ensure stability in

the global liner fleet, have gone in the EU and many other jurisdictions, and the ‘special case’ for shipping is not accepted by competition regulators (as shown by the EU withdrawing its sector-specific maritime guidelines). Moreover, while a single global regime may be highly attractive, and there are increasing levels of inter-authority cooperation, countries such as China will not cede jurisdiction to a supra-national regulator anytime soon. Thus, the current inefficiencies and uncertainties of multiple regulatory reviews are here to stay and need to be managed if global shipping alliances are to succeed.

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# Overseas Shipholding Group

## A case study for effective use of US bankruptcy laws

**International shipping companies, including Marco Polo Seatrade, Omega Navigation, TBS International, TMT Procurement, General Maritime, Excel Maritime and Genco Shipping & Trading, are increasingly seeking bankruptcy protection in the United States.**

These companies, many with minimal US ties, seek the protection of US bankruptcy laws because they provide the best opportunity for successfully restructuring their debts and operations. The recent Overseas Shipholding Group (OSG) bankruptcy cases illustrate the success that can be achieved in restructuring an international shipping business enterprise under US bankruptcy law.

On November 14, 2012, OSG and more than 90 affiliated companies sought relief under Chapter 11 of the US Bankruptcy Code in the US Bankruptcy Court for the District of Delaware. Although OSG has a significant international flag fleet, including most major vessel classes (ULCC, VLCC, Suezmax, Aframax and Panamax vessels), as a US entity with a Jones Act fleet it did not face the same scrutiny as other debtors filing for bankruptcy in the US. However, as demonstrated by cases such as Marco Polo and TMT, US bankruptcy courts are generally reluctant to dismiss bankruptcy filings even when the debtors' only US assets are retainers held by professionals.

Under US bankruptcy law, the debtor remains in possession of, and continues to manage, its assets. Unlike

most foreign insolvency proceedings where a trustee is appointed to manage the debtor's affairs until liquidation, under US bankruptcy law the debtor becomes a 'debtor in possession' (DIP). From the debtor's perspective, this is very advantageous because a debtor can emerge from bankruptcy still in control of an operating, reorganized company. In cases of fraud or incompetence, a trustee can be appointed to operate the debtor; however, frequently all constituents benefit from the debtor's continued and uninterrupted participation in the company's operation and management. OSG remained a DIP throughout its bankruptcy cases, and, through cooperation and consensus building with its major creditors, and the skilful efforts of its financial advisors and counsel, successfully obtained extensions of the exclusive period under which only it could propose a plan to restructure its debts (the Plan).

US bankruptcy law further provides a purported worldwide 'automatic stay' preventing creditors taking action to pursue claims and remedies against the debtor and its assets, such as arresting vessels, which could have a devastating effect on the debtor's revenues and therefore its prospects

for successfully reorganizing. Although the 'automatic stay' is limited by the US bankruptcy court's ability to enforce its orders, because most international shipping banks have assets in the US, those banks face serious sanctions if they ignore the stay and exercise remedies against the debtor's assets. The 'automatic stay' has been recognized by some foreign courts, often under the UNCITRAL Model Law on Cross-Border Insolvency. In OSG's case, the 'automatic stay' was recognized by the High Court of South Africa and the High Court of Justice of England & Wales, Chancery Division, Companies Court.<sup>1</sup> The breathing spell afforded by the 'automatic stay' gives the debtor valuable time to work with creditor constituencies to formulate a plan to restructure its debts.

Although the 'automatic stay' keeps creditors at bay, a debtor can seek authority to pay certain pre-bankruptcy claims of creditors deemed critical to its operations. Without court approval, US bankruptcy law prohibits a debtor from paying debts incurred prior to the bankruptcy filing. The payment of 'critical vendors' ensures that debtors can continue their day to day operations while attempting to restructure. OSG sought and obtained authority to pay 'critical vendors' such as agent/brokers' fees and costs, bunkers, supplies, maintenance and

<sup>1</sup> Recognition and enforcement of the stay in countries outside of the US requires a filing in the foreign country. While certain foreign countries may not recognize or enforce the stay, foreign courts have been deferential to US bankruptcy law when major restructuring cases are pending in the US.

repair costs and port costs. These payments gave suppliers needed assurances to continue extending credit to OSG post-bankruptcy. As to its secured lenders, a debtor must adequately protect their claims during the pendency of the bankruptcy cases. Although adequate protection can and does take many forms, in OSG the secured vessel lenders were paid contractual interest pursuant to the loans' terms, OSG paid the lender's counsel's reasonable fees through the cases, and OSG provided necessary vessel maintenance. Consequently, secured vessel lenders never missed a scheduled interest payment and they did not have to pay counsel's fees. To ensure that the special purpose entities owning the vessels had sufficient cash for the adequate protection payments, an OSG affiliate provided a DIP loan to the SPV borrowers. Unlike many such financings, the secured vessel lenders' liens were not primed by the DIP lender, but instead the liens granted were pari passu with the liens of the secured vessel lenders. The combination of the stay, and the payment of 'critical vendors' and adequate protection, was essential to stabilizing OSG's post-bankruptcy operations.

On July 18, 2014, more than 20 months after its bankruptcy filings, OSG's Plan was confirmed and went effective on August 5, 2014. By all accounts, OSG's reorganization was an overwhelming success as its Plan paid all allowed creditor claims in full, or otherwise left them unimpaired. OSG's secured vessel lenders were paid in full (including a portion of default interest) in cash on the effective date, several years prior to the loan maturity dates. Moreover, critical members of OSG's management team remained in place after its emergence from bankruptcy.

There can be no guarantee that results similar to those in the OSG cases will be achieved in all cases. However, the

OSG cases amply demonstrate that US bankruptcy law provides a special and unique platform for restructuring an international business enterprise, such as those found in the shipping industry. As such, any international shipping company businesses with at least minimal connections to the US, and their major creditors, especially international financial institutions, should carefully consider the use of US bankruptcy law to restructure the company's business operations.

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# Hong Kong, Marshall Islands and Panama flag –

## A comparative analysis

In this article we will provide a broad overview of the rules and regulations governing Hong Kong, Panama and Marshall Islands flag including a brief analysis of the merits of each flag. We do not offer any opinion as to preference. As always, the devil is in the detail and we have comprehensive guidance notes for registration of title and mortgage available separately on request.

Currently in Asia (particularly Hong Kong and China) we very often see owners, operators and lessors choosing (and financiers accepting) Hong Kong, Panama or Marshall Islands as the flag state for their vessels. The reasoning behind choice of flag is the topic of an article in itself and will not be addressed here suffice to note that all three flags are widely accepted by financiers (noting the flag will determine the governing law of the mortgage over a vessel) and we have rarely (if ever) seen a financier refuse to finance on account of a counterparty's choice of one of these three flag states.

### Ownership

Ownership is critical to choice of flag. For Hong Kong flag, the special purpose company that will be registered as owner of record on the Hong Kong Shipping Registry (HKSR) must either be incorporated in Hong Kong or registered as a non-Hong Kong Company under Part 16 of the

Companies Ordinance (Cap 622 of the Laws of Hong Kong). This will require an analysis of the tax position in Hong Kong but the incorporation of a Hong Kong company is now very quick (around two business days). However, companies incorporated overseas (whom intend to fly Hong Kong flag) may take significantly longer to register as a non-Hong Kong Company. In practice, this has caused issues, particularly for sale and purchase. To explain in brief, if a memorandum of agreement has been signed and notice set at 21 days, it is unlikely that an overseas buyer under the MOA will have sufficient time to register as a non-Hong Kong Company, if they wish to transfer to HK flag on the delivery date. Panama does not have this issue (as nationality of ownership for Panama flag is not regulated). The Republic of the Marshall Islands will permit any Marshall Islands incorporated company to fly Marshall Islands flag and any entity which is a registered foreign maritime entity under s.119 of the Marshall Islands Business Corporation

Act, which typically takes around a day to file and process.

### Type of vessel

For the more common types of commercial ships (bulkers, tankers, containerships), all three flag states will accept registration subject to the usual due diligence. Hong Kong and Panama flag put specific restrictions on certain types of vessel (fishing vessels etc.) although the Hong Kong Shipping Registry is more proscriptive of the types of vessels it will not accept (i.e. nuclear vessels, fish processing plants, mobile offshore drilling rigs). Marshall Islands does not have restrictions on the type of vessels it will accept (and has a number of fishing vessels on its registry). There are age limits for Marshall Islands flag (around 20 years generally) before which a pre-registration survey or waiver is required. However, Hong Kong flag (which has a stringent survey system in place prior to acceptance) does not stipulate age restrictions. Panama no longer has any age limit for vessels to be registered nor does it have a mandatory inspection for vessels over 20 years old now. However, the Panama Maritime Authority (PMA) may refuse entry onto the register if the vessel has a bad history.

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## Mortgages

Hong Kong mortgages are 'statutory' in a form prescribed by the Hong Kong Marine Department and are bi-lingual, in English and Chinese. The sections of the mortgage that require user completion do not provide very much space. This can be problematic for large cross-collateralised ship financings although the form must be printed on A3 paper and the blank reverse side of the mortgage can be used if needed. Conveniently, the mortgage need not be notarised or legalised before it is presented to the HKSR for registration although if the signatory of the mortgagee signs under a power of attorney given outside Hong Kong that power of attorney must be notarised and the original presented to the HKSR. The rules in Panama are slightly more complex although a ship mortgage given abroad may be recorded through a Panamanian consulate with maritime functions or an Economic Commercial Office with maritime functions. Such mortgages must be notarised and apostilled and (finally) recorded at the Public Registry in Panama. There is no prescribed form of mortgage for the Republic of the Marshall Islands and a ship mortgage can be recorded at any office of the Marshall Islands Maritime & Corporate Administrators, Inc. Usually the mortgage should be in English (although there are a couple of exceptions to that rule) and it will require notarisation or acknowledgement by a special agent of the Commissioner of Maritime Affairs. For all three flag states, mortgagees do not have to be resident in the relevant jurisdiction to take the benefit of a mortgage.

## Registration

All three flags have a provisional and a permanent registration procedure. In Hong Kong and the Marshall Islands, provisional registration is not a prerequisite to permanent registration

but it is required in Panama, before the owner can obtain a permanent navigation license. In Hong Kong and the Marshall Islands, full registration is permitted until the vessel is deleted. However, in Panama, a permanent registration license is valid for up to five years. The Marshall Islands and Panama permit dual/parallel registration (subject to the rules of the other flag) but Hong Kong has an absolute ban on dual registration – the vessel is either on the HKSR or off and there is no provision for suspended registration at all. Closure of the register is straightforward in Hong Kong, once all (existing) mortgages have been discharged. Consular officials must obtain authorisation for cancellation from the PMA where a request for cancellation of registration from the Panama Registry is received from abroad. Deletion from the Marshall Islands Registry requires the owner to submit a written request for a Certificate of Permission to Transfer.

## Demise/bareboat charter registration

Demise charter registration procedures exist for all three flags, noting that for Hong Kong, the demise charterer must meet the same ownership requirements as an owner (i.e. either incorporated in Hong Kong or registered as a non-Hong Kong Company under part 16 of the Companies Ordinance). Bareboat charter registration in the Marshall Islands is limited to two years and may be renewed every two years until the expiration of the bareboat charter. Dual registration in Panama may now be obtained for the duration of the bareboat charter and the previous limit of two years is no longer applicable.

## Tax

Income derived from the international operation of Hong Kong registered ships is exempt from profits tax in Hong Kong.

Likewise, all revenues from Panamanian flagged ships (including any capital gains from the sale or transfer of a Panamanian flagged ship) are exempt from tax. The Marshall Islands statutorily exempts non-resident domestic corporations from tax.

## Summary

Hong Kong has perhaps the most stringent requirements of all three flag jurisdictions, although once full registration has been completed, it is valid indefinitely. The Panamanian registration system is more flexible (for example, the ownership restrictions are relaxed) but the permanent navigation license is only valid for a maximum of five years. Marshall Islands, with its balanced rules and regulations, is fast becoming popular among owners and financiers. All three flags are generally acceptable to an owner's financiers and they will ordinarily readily accept a Hong Kong, Panamanian or Marshall Islands mortgage as collateral for a loan.

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# 'As is-where is'

In our June 2013 edition of *Legalseas*, we wrote about the English Court's consideration of the application of the Sale of Goods Act 1979 (SOGA) to the sale of a second hand vessel and the meaning of 'as she was' in the Norwegian Saleform 1993 (Saleform 93) following the landmark decision in *Dalmare SpA v Union Maritime Limited, Valla Shipping Limited (Union Power)* [2012] EWHC 3537 (Comm).

Following on from the issues raised by the *Union Power*, below we consider the impact of *Michael Hirtenstein, Il Sole Limited v Hill Dickinson LLP (Il Sole)* [2014] EWHC 2711 (Comm) in which the Judge expressed his views on the meaning of the words 'as is-where is' and whether they are sufficient to exclude the implied terms of SOGA as to satisfactory quality.

## The Union Power

As a brief reminder, in the *Union Power* case the parties entered into an MoA on the Saleform 93 for the *Union Power* and the vessel was delivered to the buyers on October 1. On her first ballast voyage the main engine broke down as a result of the failure of the number two crankpin.

The buyers sought damages for breach of the implied term as to satisfactory quality implied into the MoA by virtue of s14(2) of SOGA. The sellers unsuccessfully tried to argue that the words 'as she was at the time of

inspection' amounted to an 'as is-where is' sale and therefore the implied terms in the SOGA as to satisfactory quality were excluded. Although there is a superficial similarity between the two sets of wordings, the Tribunal held that argument was unsustainable because the meanings are different. Accordingly the term as to satisfactory quality was to be implied into the MoA and the sellers were therefore in breach.

On appeal, the Court upheld the Tribunal's decision. Importantly the Court also went on to consider what the term 'as is-where is' would have meant, if it had been incorporated into the MoA. The Judge held that in the absence of any evidence as to customary meaning, the words 'as is-where is' were not sufficiently clear to exclude the SOGA implied terms. The Judge felt obliged to recognise the large body of English case law to the effect that, if a party wishes to contract out of the SOGA implied terms, the exclusion must be made abundantly clear in the contract. He went on to express

a provisional view that if a contract required a buyer to take a ship as is-where is, the effect was that the buyer had no right to reject the ship on the grounds of breach of an implied term, but would be entitled to claim damages for breach of that term.

The conclusion following this case was that parties wishing to exclude the implied terms of the SOGA should use clear and express wording to do so, and that 'as is-where is' may not be enough to achieve this.

This decision was viewed with some surprise by many in the shipping industry as it did not reflect the commercial understanding of what 'as is, where is' means in commercial business.

## Il Sole

In the *Il Sole* case, solicitors Hill Dickinson were advising Cayman Islands businessman Michael Hirtenstein in relation to the purchase of a second hand yacht for £3.6 million. Hirtenstein, who had planned to propose to his girlfriend on board, bought the yacht in 2010 without a survey or sea trial, but with a warranty on the yacht's condition from the seller. Within one hour of the yacht's purchase, its engine suffered a major failure 12 miles offshore.

In the course of his decision, the Judge referred to the *Union Power* case and

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expressed a completely different view to Flaux J on the meaning of the words 'as is-where is'. He stated:

'I would regard that phrase as self-explanatory. It clearly signified that the Buyer would acquire the yacht in whatever condition the boat was at the time of purchase with no right to complain subsequently if the boat should turn out to have any defect'.

The Judge then referred to the provisional view expressed in the *Union Power* case, to the effect that the words 'as is-where is' did not exclude implied terms, but merely excluded a right of rejection in respect of breach of those conditions. The Judge in *Il Sole* stated:

'In a contract between commercial parties such an interpretation would seem to me to be generous to the Buyer. Drawing such a distinction between the right to reject and the right to damages and treating the words 'as is' as excluding the former but not the latter seems to me most unlikely to reflect the expectations of ordinary business people or to be an interpretation that would occur to anyone other than an ingenious lawyer.'

As with the *Union Power*, the Judge's comments in this case did not form part of the ratio of the decision and as such are not binding. Nonetheless, we now have two Commercial Court Judges adopting different stances on what 'as is-where is' means and whether this wording is sufficient to exclude SOGA.

## Conclusions

The question remains as to whether 'as is-where is' or 'as is-where lies' on its own is sufficient to exclude SOGA. While the views expressed in *Il Sole* indicate that it might be, if parties wish to exclude implied terms as to satisfactory quality, it is important to use clear, express and unambiguous wording to do so.

An alternative method of excluding SOGA is to incorporate an entire agreement clause such as that which is contained in the 2012 version of the Norwegian Saleform. This clause expressly excludes 'any terms implied into this Agreement ... to the extent that such exclusion can legally be made'. The efficacy of using such a provision to exclude implied terms will, of course, always depend on the other terms in the agreement such as conditions, warranties or representations.

In particular, it is essential that the parties do not dilute the effect of 'as is-where is' type wording or other exclusionary clauses by including in the contract express terms as to the condition of the vessel. Where terms are included in the contract which are contradictory to, or otherwise bring into question an exclusion clause, the court will interpret those inconsistencies against the person seeking to rely on them.

This issue will undoubtedly come before the English Courts again, but until we have a binding decision, parties should adopt a cautious approach and use either clear wording or incorporate an entire agreement clause, if the intention is to exclude SOGA.

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