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In defence of bunker traders

Hamed Fathi of IME argues that bunker traders play a vital, and often unsung, role in supporting the maritime industry

The bunker industry is an interesting place to be. It is a specialised area of business, which on a surface level could be described as simply providing the shipping industry with the fuel that its vessels need. Yet, underneath this lies a far more complex web of overlapping sectors, namely the maritime, energy and the banking and finance sectors. Each of these sectors has its own set of rules, intricacies and common practices that impact the daily operation of the services provided in the overlapping zone between all of them. However, all too often, some of the parties involved in a bunker trade fail to appreciate the practical reasons behind some of the more drastic causes of action open to a bunker trading business when a vessel owner or charterer defaults in payments, or more seriously, takes advantage of the credit line made available to them. In this article we look at some of the risks assumed by bunker traders and explain the main reason why they need to be protected for the maritime industry to be able to continue to operate successfully.

BUNKER TRADER/SUPPLIER CREDIT VERSUS TRADITIONAL LENDING

Let's look first at the financial side of the role that bunker trading businesses play in the industry. Where bunker traders and/or physical suppliers extend credit to their clients (shipowners, charterers or other related parties), they are essentially putting themselves in the shoes of a financier, which can create tensions between the borrowers (i.e. the shipowners and/or the charterers etc.) and the financier (the trader or the physical supplier providing the credit). When entering into these credit arrangements with a bunker trading business, the borrowers seeking credit can often forget that, outside the maritime industry, if they had to approach a bank to borrow funds, this would be an extremely time-consuming negotiation and verification process. Depending on the size of the potential borrower, the negotiation power of the parties can vary and, in most instances for ordinary borrowers, the lenders will dictate the terms of the borrowing to them. Many forms need to be completed, there has to be detailed and often intrusive due dili-

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gence on the party to enable the bank to assess whether the potential client is acceptable to them from a risk perspective, and last but not least, various and extensive forms of security and guarantee will be requested by the bank (often referred to as the collateral).

Viewed from that perspective, entities that engage in the business of advancing credit to shipowners, charterers etc. can be seen as part of the shadow banking industry – where they provide banking type services to their clients without formally operating as a licensed bank. Although the provision of 'banking services' is normally heavily regulated by governing bodies in each jurisdiction, this small part of the shadow banking industry usually falls within the 'tolerated practice' for most countries. It could be described as a grey zone where the conduct of unlicensed banking activity is tolerated by the relevant Central Bank and local regulators.

Problems can therefore arise where the parties overlook the fact that what lies beneath each bunker supply with a credit period is in fact a financing deal[1], where the parties are assuming the roles of borrower and lender. Bunker traders and suppliers can sometimes be accused of conservative or protectionist behaviour in their credit risk assessment, terms of sale and recovery attitudes, which ignores the tremendous risk these businesses have to take as creditors of the vessels that sail around the world. But without their role in this industry and as stakeholders operating in this field, the question we should all be asking ourselves is how would the maritime sector operate if each time a shipowner or charterer required credit, they had to complete multiple forms, provide detailed due diligence and in depth financial information on their company and operations, and more importantly, security over the vessel and company shares etc. in return for the advance of that credit. In that respect, the service provided by bunker traders introduces significant flexibility and facilitates global trade, and should therefore be viewed in that way and protected accordingly.

In contrast, should shipowners / charterers purchase fuel on a 'cash in advance' basis, whereby no advance of credit is required, there would be no need for the creditors to behave in a protectionist manner. The criticisms levelled against the traders and suppliers often ignores this simple fact. The instruments for enforcement (for instance, arrest of the underlying vessel through various mechanisms such as 'retention of title' clauses or other payment default and acceleration provisions) therefore become necessary tools in maintaining the integrity of the industry.

RISKS TO CREDITORS, THE IMPACT OF RECENT MARKET TURMOIL AND COLLAPSE OF MAJOR COMPANIES

The departure and catastrophic collapse of well established companies such as OW Bunker and Trading, Hin Leong Trading, GP Global and Fairdeal Traders in Fujairah, and the string of legal cases and judgments that followed, has only increased the pressure on these intermediary financiers – whether due to banks losing their appetite to provide trade finance to bunker traders / physical suppliers, or their inability to recover unpaid debts in cases of financial distress.

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And we need to add to that the additional risk the bunker traders/suppliers are required to absorb in an event of insolvency of a debtor (whether they are the vessel owner, charterer or other trading companies undertaking back-to-back deals for their ultimate end-user client) – as unsecured creditors without any registered security over collateral of the debtors, they can be ranked quite low in the order of priority in the insolvency of a debtor. For instance (and broadly speaking), US law considers an unsecured debt to be seventh in the priorities queue, behind (i) expenses of justice, (ii) unpaid crew wages, (iii) salvage and general average liens, (iv) tort liens such as personal injury and death, (v) pre-mortgage statutory maritime liens for necessities, and (vi) preferred mortgages over the vessel. Many other legal systems (for instance English law, Singaporean law, etc.) take a similar view to that of the US law. This means that the risk bunker traders/suppliers take to extend a smooth and rapid (same day) credit line to the shipowner or charterer to enable them to purchase bunker fuels is significantly increased by their low ranking in the list of priorities in an event of insolvency of the debtor.

These are some of the reasons why banks are not always quick to approve credit, require the credit facility to be properly documented in lengthy loan agreements, and seek extensive security over a borrower's assets. By the same token, these are also some of the reasons why it is important for all stakeholders to protect the bunker traders and suppliers that provide this service to the maritime industry.

NEXT ARTICLES

In a series of articles in future editions of *Bunkerspot*, I will set out to highlight some of the other key issues facing ships, shipowners, charterers, bunker traders and physical suppliers.

I will also look to focus specifically on some of the relevant factors for creditors to consider when assessing the creditworthiness of a potential client, such as the registered flag state of the vessel, jurisdiction of incorporation of the owner of the vessel, the voyage pattern of the vessel, the age and value of the vessel, the type of contracting party and any risks associated with that type of entity, and finally, the financial health of the borrower.

Related to that, we will look at some enforcement pitfalls when dealing with a defaulting debtor (shipowner, voyage charterer or time charterer, agent or bunker trader), notably considering the issues arising from the OW Bunker, Hin Leong and GP Global cases and discussing tensions around the transfer of risk and title between the parties, paying particular attention to how legal systems around the world have set out to protect the financiers and what enforcement challenges exist.

1. Unless a supply is made on a 'cash in advance' basis, the trader / supplier is required to provide a credit. A misconception can arise in the case of 'cash on delivery' deals, whereby the purchaser of the bunker fuels assumes that no credit is being sought as payment is being made upon completion of delivery of the bunker fuels. However, in almost every case, payment is received by the trader / supplier after a minimum of one to seven days, which in effect forces the seller to act as creditor while payment remains outstanding.

Hamed Fathi,
International Marine & Energy DMCC

Email: hamed.fathi@ime-uae.com
Web: www.ime-uae.com