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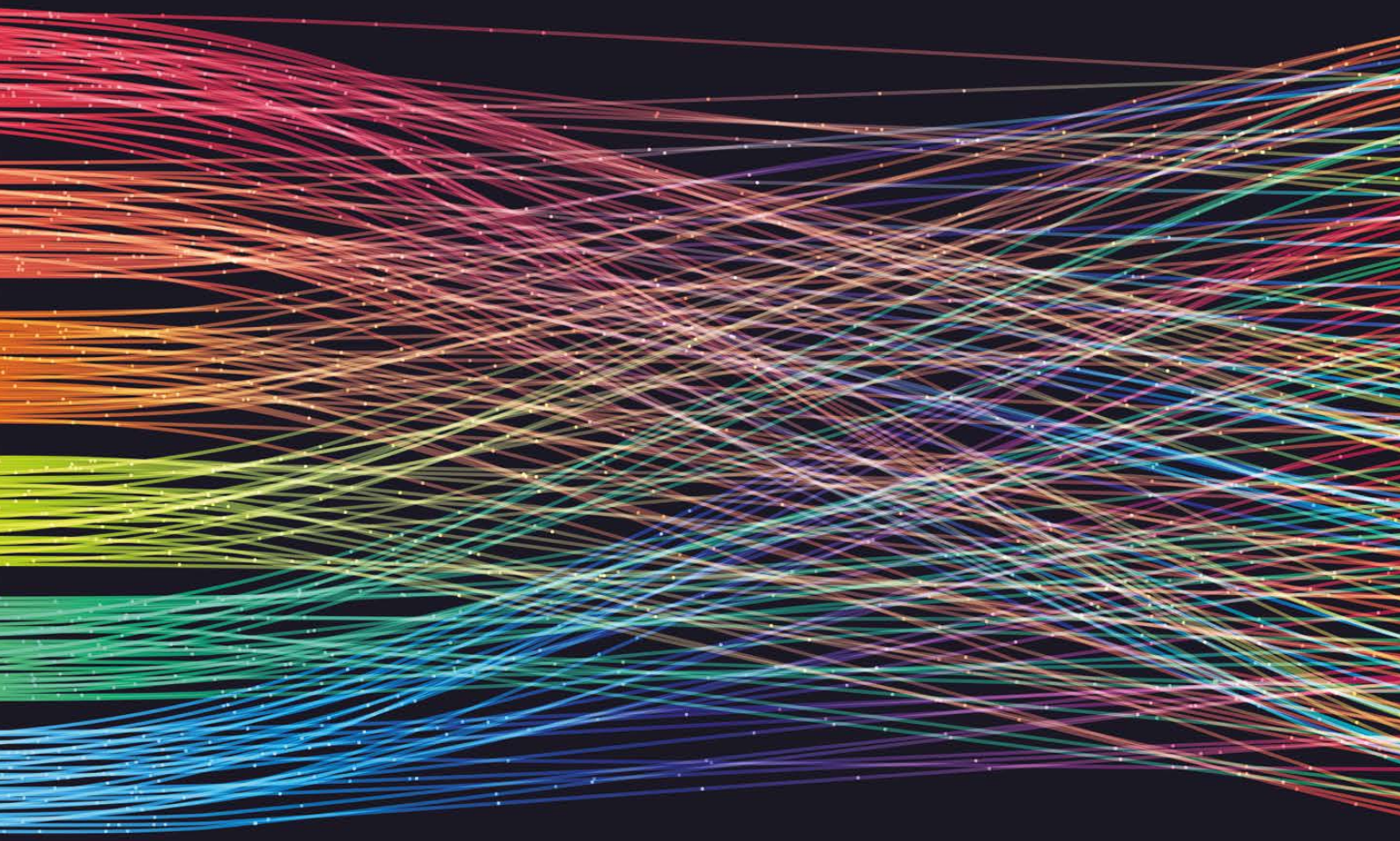
BUNKERSPOT

DATA IS KING

BUILDING THE CASE FOR MASS FLOW METERS



INSIDE:

MARINE LUBRICANTS
DEBT RECOVERY
BIO-LNG
ELECTRIC PROPULSION

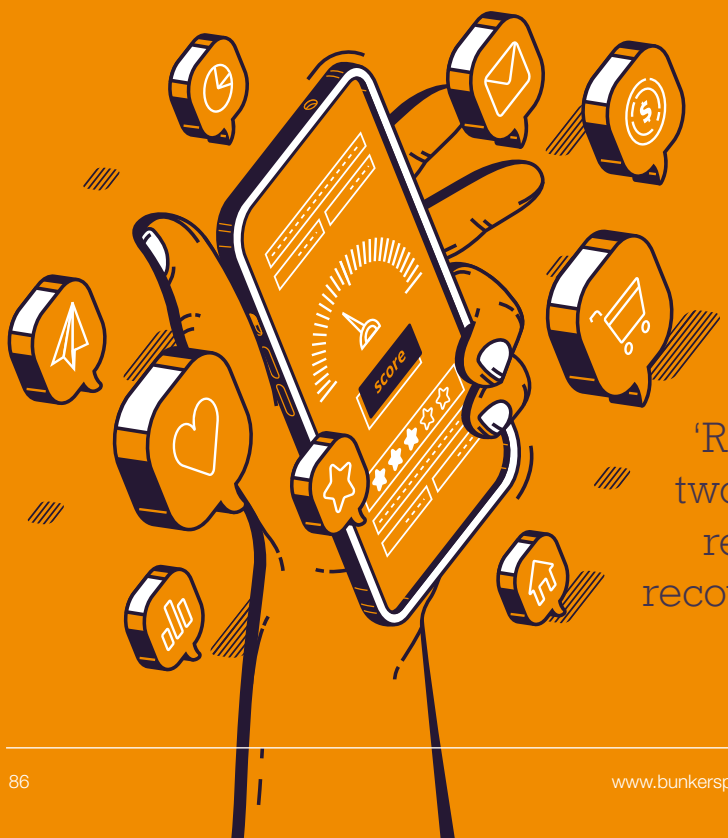
Credit control

Hamed Fathi of IME looks at the issues that need to be considered when assessing credit risk in the bunker industry

One of the most common elements of a bunker trading / supply business is reliance on large volumes of 'low margin' bunker deals, that are in turn financed by banks and financiers with a lower margin / interest credit facility, enabling the bunker trader to make enough profit overall to make the enterprise sound[1]. Looking at this business model in isolation, however, the inherent risk will always remain that the moment that cheap financing becomes scarce, the model becomes conceptually difficult to sustain. Bunker traders that rely on this model then have no choice but to pass that additional cost of finance to their end user clients.

This has made speculation about a potential credit crunch in the bunkering industry one of the favourite topics of the last few years. First came the financial crisis of 2008, followed by the collapse of key industry players such as OW Bunker (November 2014), volatility in oil / bunker fuel prices in late 2019 and early 2020 due to the implementation of IMO 2020 regulations, the COVID 19 crisis which gathered momentum in 2020, the Hin Leong fiasco in April 2020, and now the conflict between Russia and Ukraine. These unforeseen events have all worked hand in hand to ensure that the threat of a looming credit crunch in the industry remains topical for all stakeholders.

As noted in our previous article in the October/November issue of *Bunkerspot*, the business of advancing credit (or in other terms, lending) is itself a banking-style activity[2]. Viewed from that perspective, if we (as the bunkering industry) are going to engage in banking-style behaviour, we must first try to learn how the banks manage some of their risks so that we can mitigate some of those risk too. By having a proper risk-based approach to advancing credit to our clients, more reassurance can in turn be provided to the banks and financiers that underwrite the business, in order to maintain the necessary liquidity in the market. In this article, we will try to focus on what some of those key considerations are for bunker traders and physical suppliers, which the owners and charterers etc. need to be aware of in their quest for opening and maintaining credit lines.



PROFILE OF A CREDITWORTHY CLIENT

When approaching a financier (be it a bank or other entities operating in the 'shadow banking' industry such as funds, bunker trading companies, suppliers etc. that also provide credit lines), the ability of the vessel owner or the charterer seeking that credit to step into the mind of the financier will be very important – what are the key criteria that the financier will inevitably consider in their risk assessment, and how should one structure its business to make it less risky and thus more attractive to a potential creditor?

Risk assessment ought to be seen in two parts: (a) the borrower's ability to repay the debt, and (b) the ability to recover the debt if the borrower fails to repay that debt for any reason. The obvious place to start is the financial statements of the potential borrower, which in part goes to the earlier point. However, this should arguably be one of the last items one should look at in their assessment of the risk of the borrower, as the real risk (in the unfortunate event that it does precipitate) lies in a creditor's inability to recover if the purchaser of the fuel fails to pay its invoices. For the purposes of this article, we will therefore start in the inverse order of looking at recovery first, before checking the financial health of the buyer / borrower:

(a) **jurisdiction of incorporation of the buyer / the debtor:** inevitably, when contemplating the question of risk assessment, the bunker trader will look at the jurisdiction of incorporation of the client. The banks do not lend to companies estab-

'Risk assessment ought to be seen in two parts: (a) the borrower's ability to repay the debt, and (b) the ability to recover the debt if the borrower fails to repay that debt for any reason'

lished in 'risky' jurisdictions, and by the same token, bunker traders and suppliers should be very hesitant to do so too. For the purposes of this article, reference to 'risky jurisdictions' means jurisdictions where taking recourse against a defaulting party is not straightforward;

(b) **jurisdiction of incorporation of the owner of the vessel:** it is not uncommon for the purchaser of the bunker fuels to be a different entity to the registered owner of the vessel. This may be because the vessel is held by a special purpose vehicle company that undertakes no trading activity (to protect the vessel), or perhaps because the entity purchasing the fuel is the charterer, manager of the vessel, a trading company, an agent of the owner or charterer etc. In these circumstances, if the jurisdiction where the registered owner of the vessel is based is not one where recourse may be had against the vessel, the creditor / bunker trading company will take that into consideration as a factor that increases its risk of recovery in the event of non-payment. Therefore, owners electing to register the owning entity in opaque jurisdictions are inadvertently increasing the risk profile of the vessel from a credit perspective, in turn reducing the appetite of traders and financiers to provide fuel on credit terms to that vessel or charterer etc.;

(c) **flag State of the vessel:** the flag of the vessel can be seen as another indicator of the creditworthiness of a buyer or a vessel. If the vessel is subject to strict regulatory supervision (by virtue of maintaining a flag that has more stringent requirements), it will be seen as a better managed vessel, and by extension, a more creditworthy client. By the same token, if the underlying vessel maintains a less proactive flag authority, perhaps on the basis that the flag will not intervene by imposing injunctions in the event of breaches by the owners and operators, that will inevitably increase the risk profile of that particular client, hence reducing their chances of successfully obtaining supplier credit lines;

(d) **age and value of the vessel:** as noted in our previous article, the process of obtaining a credit line from a bunker trading house / supplier is often a less arduous one when compared to banks. This is because traders and suppliers often derive some limited comfort from the fact that there is an underlying asset (the vessel being supplied with the fuel) that they may have recourse to if there is a failure to settle their invoices[3]. Consideration of the age and value of the vessel is naturally a pertinent point when it comes to the question of credit risk assessment;

(e) **trading route / pattern of the vessel:** where the legal landscape of the jurisdictions that make up the usual trading route of the vessel are deemed to be less investor friendly (i.e. where a financier / creditor's ability to recover its debt and unpaid invoices is diminished by the lack of predictability of the legal system of that country, or where the legal system is protective of the owners and charterers and impedes a creditor's ability to recover its debts), that will impact a financier's decision to lend in such circumstances; and

(f) **type of contracting party:** the least risky entity for a trader or supplier to sell on credit to is the registered owner of the vessel itself. This creates a direct obligation between the two sides with clearly enforceable obligations by both parties – the obligation to supply and deliver the right product in a timely manner and in accordance with the commercial agreement between the parties, versus the obligation to pay the debt on time. As the number of entities in the middle increase, the risk profile changes with it. For instance, in the jurisprudence that followed from the string of OW Bunker cases, for a while back-to-back trades involving traders (more than one trader even) were deemed more risky from a recovery perspective, although most courts have managed to alleviate those fears and re-establish confidence in the role of bunker traders. Likewise, selling to time-charterers should be considered as more risky compared to the registered owner as there are certain jurisdictions that do not facilitate easy recovery against the underlying asset if the sale was made to a former time charterer of the vessel who is no longer operating the vessel.

This list is not exhaustive and should be viewed as indicative only – the more attention that is paid to making these factors available to a potential trader / supplier, the more likely it is that they would be willing to supply bunker fuels to the vessel on credit. Conversely, if owners seek to engage in overly protective behaviour by trying to limit a trader or supplier's ability to recover, they will likely struggle to secure credit lines through their supply channels.

Once these points are considered, a lot of traders and suppliers will have formed a general idea as to whether they are in a position to advance credit or not. In the final stage, the financials of the company should be checked to ensure that it clearly has the ability to repay its debts and that the company is sound and profitable (hopefully to avoid ever having to resort to recovery and enforcement).

MITIGATING RISK

All traders and suppliers must do more to mitigate their risks and reduce their chances of being hit with bad or doubtful debts. One way of doing so is to ensure that their terms of business properly cover the risk of non-payment and provide the right framework for recovery in payment-default scenarios. Other important strategies to consider include seeking credit risk insurance from their banks and other service providers, and most importantly having the right advisors to assist with recovery of defaulting debts.

In our forthcoming articles, we will try to explore some of the pitfalls that bunker traders and suppliers need to be aware of when seeking to recover against defaulting invoices. Related to that, we will try to shed some light on some of the key components of a properly drafted set of terms and conditions, seeking to highlight some of the day-to-day risks and how they may be managed by the parties contractually.

1. The set up of bunker trading and physical supply businesses is of course far more sophisticated than the suggestion here. The intention is to draw attention to a very specific part of the complex machine, in order to allow us to explain the points highlighted in this article.

2. Some legal systems (though not all) go insofar as describing advancing of credit as a "banking activity" that they seek to regulate. In some such regulated environments, companies that engage in limited banking style activities are often "tolerated" by the regulators on the basis that "banking" is not the core business of that enterprise, but rather one element of the wider services being provided).

3. This approach can create tensions between owners of vessels and creditors where vessels are chartered to third parties, as the owner takes the view that they were not the defaulting party. Legal jurisdictions that do afford protection to bunker traders / suppliers in these scenarios take the alternative view that the entire industry manages to facilitate rapid credit lines by taking comfort in the existence of a valuable asset, and if that were to be removed from the equation, it would seriously undermine the industry by significantly increasing the risk creditors are exposed to. A bank would not lend without taking security over some assets (tangible and / or intangible) and bunker traders / suppliers should not be expected to be exposed to risk of non-payment without some loose form of security being afforded to them. These jurisdictions place some burden on shipowners to do their due diligence on charterers, something that bunker traders and suppliers place some reliance on (i.e. that the shipowner would have done significant due diligence on the charterer before agreeing to place charter such a prized asset to them).

Hamed Fathi
Director | General Counsel,
International Marine and Energy

Web: www.imebunkers.com