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Industry insight: Falling dominos – the OW Bunker's corporate collapse

On 7 November 2014, OW Bunker A/S, the world's largest ship fuel supplier and the third largest Danish company filed for bankruptcy in Denmark. OW Bunker's network of subsidiaries extended to the US, Singapore, Germany, China and UAE. Most of the subsidiaries also filed for bankruptcy protection in their country of incorporation. OW Bunker's collapse left an outstanding debt of $750 million owing to 13 banks, amid financial scandal and allegations of fraud by senior employees. The ripple effects of this catastrophic corporate collapse will continue to be felt around the globe for years to come, as creditors struggle to maximise their recovery.

Parties affected by the collapse necessarily include vessel owners, charterers, local fuel supply intermediaries and banks alike. One bank embroiled in the saga is ING Bank N.V., to which OW Bunker charged all rights, title and interest in its receivables.

The collapse of OW Bunker has seen an avalanche of cross border actions around the globe, with the intertwining of insolvency laws and maritime laws of different jurisdictions. This has lead to often conflicting decisions in different jurisdictions. What lessons can be gleaned from this maelstrom?

On 11 May 2016, in the test case of in *PST Energy 7 Shipping LLC & Anor v OW Bunker Malta Ltd & Anor (The "Res Cogitans")* [2016] UKSC 23, the UK Supreme Court dismissed an appeal from an earlier decision which considered whether ship owners should pay OW Bunker/ING on the one hand or the ultimate bunker supplier on the other for the cost of the bunkers. This decision has potentially significant widespread ramifications.

Fallout from OW Bunker's collapse

As OW Bunker is now subject to bankruptcy proceedings, unpaid bunker suppliers are seeking to recover payment or obtain security for their claims. Faced with the prospect of nil return, they are turning to *in rem* proceedings against the receiving vessels and seeking to arrest those vessels.

Ship owners and charterers find themselves facing threats of arrest and demands for payment by competing parties for the same bunker supply. They run the risk of multiple claims for the same bunkers – (a) firstly by the physical bunker supplier pursuant to a maritime lien recognised in only some jurisdictions and (b) secondly to OW Bunker (or ING as assignee) under the bunker supply contract. This risk exists even

Key issues

- OW Bunker's collapse has seen ship owners and charterers face the risk having to pay more than once for the same bunkers – to the physical bunker supplier and/or to OW Bunker under the bunker supply contract.
- Ship owners and charterers must carefully consider each claim for payment of bunkers before deciding if a payment should be made and if so to whom.
- As evident from the litigious aftermath of OW Bunker's collapse, the result is likely to depend on the jurisdiction in which the claim is brought.

where ship owners or charterers have already paid one party for the bunkers.

Background

On 31 October 2014, owners of the vessel *Res Cogitans* ordered bunkers from an OW Bunker subsidiary, OW Bunker Malta Ltd. The bunker supply contract incorporated OW Bunker's standard terms and conditions, including: (a) payment on credit within 60 days after delivery, (b) permission to use the bunkers before payment and (c) a retention of title clause pursuant to which property in the bunkers would not pass to the ship owner/charterer until the bunkers had been paid for in full - even where the bunkers were mixed with fuel from other suppliers in the vessel's tanks. The bunker supply contract with OW was governed by English law.

OW Bunker Malta Ltd ordered bunkers from its parent company OW Bunker A/S. OW Bunker A/S in turn ordered the bunkers from a bunker supplier, Rosneft Marine (UK) Ltd (**Rosneft**), who then contracted with its Russian affiliate, RN-Bunker Ltd, to provide the bunkers to the vessel.

The contract between OW Bunker A/S and Rosneft required payment within 30 days of delivery and was subject to Rosneft's standard terms and conditions, which included a retention of title clause.

The bunkers had been wholly consumed by the vessel. When OW Bunker and its subsidiaries filed for bankruptcy, the ship owners had not paid OW Bunker Malta Ltd and OW Bunker A/S had not paid Rosneft.

The bankruptcy constituted an event of default under the finance arrangements between the OW Bunker Group and ING. ING asserted its right (as assignee) to recover the debt owed by the ship owners to OW Bunker Malta Ltd in respect of the bunkers.

Rosneft asserted that it remained the owner of the bunkers and threatened to seek payment from the owner of *Res Cogitans.*

So began the ship owner's legal woes. They face multiple claims for payment for the bunkers: (a) one claim by ING Bank (as assignee of debts owed to OW Bunker); (b) a second claim by Rosneft, as the physical bunker supplier, relying on the retention of title clause to assert that it remained owner of the bunkers.

Litigation History

This matter has a long litigation history. In early December 2014, the ship owners commenced arbitral proceedings against OW Bunker Malta Ltd and Rosneft, seeking a declaration that they had no liability to pay OW Bunker and/or ING for the bunkers. The ship owners argued that the bunker supply contract was a contract for the sale of goods, to which the UK Sale of Goods Act applied. They argued that OW Bunker's claim for the price of the bunkers was not sustainable, despite delivery (and consumption) of the bunkers by the ship because the conditions under the UK Sale of Goods Act were not satisfied –OW Bunker did not acquire title to the bunkers and hence could not transfer title in the bunkers to the ship owner. The ship owner argued that title to the bunkers could not pass to them because Rosneft who had not been paid for the bunkers, retained title. In the alternative, the ship owner sought damages for breach of contract, alleging that OW Bunker breached a mandatory implied term in the bunker supply contract under the UK Sale of Goods Act to the effect that OW Bunker had the right to sell the bunkers.

The arbitral tribunal concluded that the contract was not one of sale within the UK Sale of Goods Act, and that OW Bunker Malta Ltd was entitled to recover the sum as a contractual debt.

In May 2015, the arbitral award was appealed to the English High Court. In dismissing the ship owners' appeal, the court held that OW Bunker Malta Ltd's contract to supply bunkers to the ship owners was not a contract of sale, but was a contract containing a condition whereby OW Bunker Malta Ltd undertook that the ship owners would have the lawful right to use any bunkers. The court held that it was not subject to any condition regarding the passage of property in the bunkers. The court expressed the view that if the Act applied, it could only be because OW Bunker Malta Ltd undertook to transfer property in the bunkers to the buyer, which it failed to do in breach of the implied term, and the total failure of consideration would provide the Owners with a defence to a claim for the price of the bunkers.

The ship owners appealed to the Court of Appeal, which substantially agreed with the High Court and dismissed the ship owners' appeal. In doing so, it contemplated that the bunker supply contract would be a contract of sale to the extent that payment was made at a time when any part of the bunkers remained unconsumed.

On 11 February 2016, the ship owners obtained leave to appeal to the UK Supreme Court. The appeal was heard on 22 and 23 March 2016. At the hearing, counsel for the ship owners stated that his law firm alone

had clients who had received 32 arrest warrants or threatened arrests from bunker suppliers, like Rosneft, and 53 similar claims from ING arising out of OW Bunker's insolvency.

UK Supreme Court's decision

Three questions were put to the UK Supreme Court:

1. Was the contract a contract of sale within the meaning of the UK Sale of Goods Act?
2. Was it subject to any implied term that OW Bunker Malta Ltd would perform its obligations to its supplier in paying for the bunkers timeously?
3. If the contract was a contract of sale within the UK Sale of Goods Act, was the relief available to OW Bunker Malta Ltd limited to the circumstances prescribed in the Act?

Was the bunker supply contract a contract of sale under the UK Sale of Goods Act?

The UK Sale of Goods Act defines a contract of sale as one "by which the seller transfers or agrees to transfer the property in goods to the buyer for money consideration, called the price." The UK Supreme Court held that OW Bunker Malta Ltd's contract with the ship owners was not a straightforward agreement to transfer property in the bunkers to the ship owners for a price - rather it was in substance an agreement with two aspects:

- first, to permit the ship owners to consume the bunkers prior to any payment without any property ever passing in the bunkers that are consumed; and,
- second, to transfer property in the unconsumed bunkers remaining to the ship owners in return for payment of the price for all the bunkers, whether consumed before or remaining at the time of its payment.

On this basis, the UK Supreme Court rejected the Court of Appeal's analysis of the bunker supply contract as a 'hybrid' contract under which OW Bunker Malta Ltd granted the ship owner a license to consume the bunkers immediately upon delivery and a sale contract for any remaining bunkers on board the vessel; which its saw as an attempt to divide up a single agreement covering the supply of all the bunkers at a single price, irrespective of what happened to them.

The Court concluded that the contract was a *sui generis* transaction - it belonged to a class of transactions that was unique and offered a feature quite different from a contract of sale of goods, namely the liberty to consume all or part of the bunkers supplied without acquiring them or having paid for them. OW Bunker Malta Ltd's obligation to pass property in any unconsumed bunkers against payment of the price for all the bunkers did not convert the agreement into a contract of sale. On this basis, the ship owners did not have a defence under the UK Sale of Goods Act to the claim for the price.

Was there an implied term that OW Bunker Malta Ltd would pay timeously?

The ship owner's alternative ground of appeal was that it was an implied term of the contract that OW Bunker Malta Ltd would comply with its obligations to the party above it in the contractual chain, in particular by paying for the goods on expiry of the relevant credit period.

The UK Supreme Court concluded, based on its characterisation of the nature of the contract as set out above, that OW Bunker Malta Ltd's only implied undertaking was that OW Bunker Malta Ltd had the legal entitlement to give the ship owners permission to use the bunkers prior to payment. For that permission to be granted, OW Bunker Malta Ltd did not need to have or acquire title to the bunkers - it merely needed to have the right to authorise such use under the chain of contracts.

As regards bunkers in existence at the time of any payment, the Court held that OW Bunker Malta Pty Ltd was obliged to be able to pass title to the ship owners. Had OW Bunker Malta Ltd been unable to do so the Court said that maybe the ship owners could have treated OW Bunker Malta Ltd as having breached a condition and terminated the contract, but would have had to refrain from further use of the bunkers. If this had been the case, the Court said that OW Bunker Malta Ltd would have been unable to maintain a claim for the whole price, and would have been able to assert either a contractual or a restitutionary claim for pro rata payment for the bunkers the vessel had consumed.

This guidance is helpful to the industry generally, although in this case, the matters before the court did not involve any claim that OW Bunker Malta Ltd did not have the right to permit use of the bunkers, and the Court concluded that, on the facts before it, the ship owners where liable for the price under the contract *sui generis*, which was not a contract of sale.

In the event that the contract was a contract of sale pursuant to the UK Sale of Goods Act, was the relief

available to OW Bunker Malta Ltd limited to the circumstances prescribed in the Act?

The UK Supreme Court stated that had the contract between OW Bunker Malta Ltd and the ship owners been one of sale, the court would have held that the UK Sale of Goods Act was not a complete code of situations in which the price may be recoverable under a contract of sale. In the present case, the Court concluded that the price was recoverable by virtue of the express terms of the contract in the event that the ship owners had completely consumed the bunkers supplied.

If such a finding was required the Court stated that it would be prepared to over-rule an earlier Court of Appeal decision in *F G Wilson (Engineering) Ltd v John Holt & Co (Ltd)* [2014] 1 WLR 2365 (known as "*Caterpillar*"), which, in this case, had bound the findings of the arbitrators, the High Court judge and the Court of Appeal. The Court of Appeal in "*Caterpillar*" held that where goods are delivered under a contract of sale but title is reserved pending payment of the price, the seller cannot enforce payment of the price by an action. On the basis of the UK Supreme Court's reasons, it can be said that this no longer represents good law.

Discussion

Given the multi jurisdictional nature of the shipping industry, ship owners and charterers need to consider the circumstances of each claim for payment carefully, on a case by case basis, before deciding if a payment should be made, and if so, to whom? Facts are likely to differ from those in *Res Cogitans* case. It would therefore be unwise to conclude that the decision in that case means that payment must always be made to OW Bunker in all cases.

It is also important to highlight that there have been decisions by other courts on cases arising out of the collapse of OW Bunker, with varying results:

- In Canada, the court in *Canpotex Shipping Services Limited v. Marine Petrobulk Ltd*., 2015 FC 1108 (2015-09-23) held that a time charterer who had ordered bunkers from OW Bunker was discharged from its obligation to pay OW Bunker by paying the bunker suppliers. The reasoning underlying the court's decision was that OW Bunker had breached its obligation to the bunker supplier to pay for the bunkers, noting that it would be bizarre and unconscionable to order otherwise.
- The Singapore High Court, in *Precious Shipping Public Company Ltd v OW Bunker Far East (Singapore) Pte Ltd* [2015] SGHC 187, held that bunker suppliers do not have any claim against ship owners in conversion. On the basis of OW Bunker's terms which allowed for bunkers to be consumed before they were paid for, the court stated that the parties intended for the bunkers to be consumed before they were paid for. This decision aligns with the reasoning adopted by the Court in the *Res Cogitans* case.
- In July 2015, a large group of ship owners and charterers filed an interpleader lawsuit in New York's US Federal Court seeking to have a judge decide who should receive payment for outstanding bunker invoices. The judge affirmed the interpleader actions, which enabled the ship owners and charterers to pay the amount due under the OW Bunker's invoices into court or post security for that obligation, and thereby obtained an injunction against bunker suppliers and OW Bunker from arresting the vessels or from pursuing their claims against the ship owners and charterers elsewhere.
- In *Newocean Petroleum Co Ltd v OW Bunker China Ltd (in provisional liquidation) & Anor (The "Cosco Felixstowe")* [2016] HKCFI 492, the plaintiff, a local bunker supplier, brought a claim of conversion against a bunker trader who the vessel owner had placed the order for bunkers. The bunker trader had in turn contracted with OW Bunker, who had finally contracted with the plaintiff. In this case, the contract terms between OW Bunker and the local bunker supplier were materially different from those in the *Res Cogitans* case, in that there was no express or implied authorisation to consume the bunkers. On this basis, the Hong Kong court held that it was arguable on the facts that there was an act of conversion in the sense of the bunker trader's involvement in an act that was inconsistent with the plaintiff's possessory or proprietary rights.

It is also worth noting that in the recent landmark case of *Reiter Petroleum Inc v The Ship "Sam Hawk" [2015] FCA 1005*, the Federal Court of Australia held that a foreign maritime lien was enforceable in Australia, and capable of founding the arrest of a ship under the *Admiralty Act 1988* (Cth). This is despite the underlying claim on which the lien

was based not being recognised as a maritime lien under Australian maritime law. Thus, ship owners and charterers may be subject to ship arrest proceedings in Australia based on claims for maritime liens for unpaid bunkers arising under foreign law, as in the case of the "*Sam Hawk*". For further reading on this topic, we direct you to our recent briefing note which is available at http://www.cliffordchance.com/briefings/2015/12/landmark_decisionarrestofthevesselsa.html.

Conclusion

The fallout from OW Bunker's insolvency has clearly had serious effects on the shipping industry, and participants are not helped by uncertainty that has been added to by the patchwork of judgments in the area.

There are a number of measures that ship owners and charterers can take to protect themselves from exposure to claims for the supply of bunkers:

- obtain waiver of claims from both the contracting party and the bunker supplier, or at the very least, minimise exposure to multiple claims by obtaining a waiver from the bunker supplier.
- incorporate the BIMCO "bunker non-lien clause" in time charter parties to protect them from claims in relation to bunkers used by defaulting charterers.
- be cautious in situations where the conditions of the bunker supply contract are provided to them, as they may provide the bunker supplier with the legal bases for enforcement against the ship owners or the vessel.
- when threatened with an arrest, ship owners and charterers should obtain legal advice from practitioners from the relevant jurisdiction. As we have seen, each case will be handled based not only on the relevant facts and contractual provisions involved; but also the law applicable to the jurisdiction.

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