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Welcoming Note

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Welcome to the 2nd Issue of Law Tides. We hope that it will continue to meet your expectations for a legal and insurance one-glance beacon!

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BREXIT:

Implications for the Shipping Industry

In 1946 and in the aftermath of the 2nd World War, Winston Churchill speaking before an audience at the University of Zurich said that "*We must build a kind of United States of Europe. The structure of the United States of Europe, if well and truly built, would be such as to make the material strength of single states less important….*".

Little did he know that exactly 70 years later, Britons would be called upon to cast their vote not for the purpose of deciding whether to move to a closer union, but rather whether they continue to wish to remain in Europe altogether.

The British Prime Minster, David Cameron having finally succumbed to his country's ever growing Euroscepticism and his own pre-election campaign rhetoric set 23rd June 2016 as the date when Britons get to decide whether the UK is to remain a member of the European Union or leave it.

Following a vote to leave the EU, the UK would notify the European Council of its decision to leave triggering the effect of Article 50(2) of the Treaty on European Union, pursuant to which the UK would enter into negotiations with the EU over a withdrawal agreement. If a withdrawal agreement is not reached after two years, then the withdrawal would become effective without an agreement.

Allen & Overy, a British law firm, contends that the entire process of disentangling the UK from the EU would take between two and possibly five years. Yet the extent and scope of disentanglement is highly dependent on the way the UK ultimately decides to part from the EU. From joining the EEA and EFTA thus continuing to have access to the single market, or forming a customs union with the EU (as Turkey has as far back as 1995) to the more radical scenario of the UK simply relying on existing WTO rules in its relationship with the EU as China has done with many of its sovereign counterparties.

Whatever the process, contingency planning and assessment of the impact of a Brexit on one's business as early as possible would be a wise choice to make.

Shipping regulation is heavily based on treaties adopted by the International Maritime Organization and involving a large number of counterparties. The primary regulations governing safety of life at sea and environmental issues are contained in SOLAS and MARPOL. The EU has also catered for these areas on regulatory level, albeit to a limited extent. Given their international scope however, it is contended that these regulatory models shall continue to apply even post-Brexit.

Laws however affecting the following areas may have an impact on shipping (either directly or indirectly) in a post-Brexit scenario:

Insurance: Passporting, the principle pursuant to which an insurer authorized in one member state can conduct business in any other member state without any additional authorization from the host state may be undermined following a Brexit. By virtue of passporting, London underwriters can write shipping risk in Greece (and indeed all other EU states) and vice versa without the need of double authorization. Following a Brexit, this ease of conducting business may be hampered as the cost of compliance would increase depending on the number of states the provider of services wished or continued to conduct business in. As a result, the ability of underwriters and shipowners alike of shopping around for the best possible prices shall be curtailed.

Capital Markets: Following a Brexit, capital markets shall undoubtedly be affected as the post Brexit landscape shall be fraught with uncertainty. Volatility shall be the norm in equity and currency trading, the value of USD, EURO or even GBP priced collateral fluctuating heavily as result. The same is to apply in the run-up to the referendum. Companies would be advised to hedge their exposure to currency and interest rate

risk as a result of such volatility which for all practical matters, will appear to be higher than usual.

Sanctions: Currently, sanctions are imposed on various countries and originate from either countries acting singly such as the USA or collectively such as the EU. Following a Brexit, the UK will most likely follow the sanctions path created by the EU but there is no guarantee that it will not impose harsher or less strict sanctions that its international counterparts. In such an event, companies that have obtained insurance or debt from firms based in the UK may have to allocate more of their sanctions compliance budget to accommodate for the UK's sanctions regime, if different from the UK, USA etc.

Free Trade: The Single Market allows trade within member states to be liberalized, good and services to move freely within the Union without internal barriers or tariffs. The same applies to citizens of the EU. Additionally, as regards to trading with countries outside of the EU, EU companies and goods benefit from a wide range of bilateral and multilateral trade treaties, their goods and services being granted with preferential treatment over their non-EU counterparts. Following a BREXIT, exporting UK goods or services would become a more complex process than at present as UK companies would no longer benefit from the freedoms of the Single Market nor from the treaties the EU has entered with

other countries. Undoubtedly, the cost of compliance and of doing business shall also increase.

Understandably, there are many uncertainties on how a Brexit may affect the way business is conducted either from or to the UK. If Britons vote for an exit, it all depends on the manner the current government decides to pursue the partition. As discussed above, the ways of divorce vary and it all boils down on the agreement Britain is to reach with the remaining 27 states that currently form the European Union. Although a relationship akin to the EEA or EFTA are more likely scenarios, recent developments on the immigration front have divided member states to a great extent, threatening thus the philosophic and fundamental values the 6 founding members of the Union had in mind after the end of World War II when they formed the first customs union.

By Michael G. Alexiou

How to Address the Immigrants-At-Sea Rescue Issue Both In Practical Terms As Well As Insurance-Wise

Within the last years and following the break-out of war or similar hostilities in various countries, especially in the Middle-East, a considerable number of people take the hard, but still realistic decision, to flee from their home countries for various reasons, them being either safety and/or financial and/or political ones.

Increasing numbers of these people, which can be characterized as holding a refugee status, frequently end up in some form of distress at sea, either being on-board poorly maintained or even unseaworthy vessels, some of them even being crew-less, during their desperate journey in search of a better life. These sort-of called boats or vessels, can unfortunately become not a refuge vehicle but extremely dangerous crafts, jeopardizing the mere lives of those on board.

As it is widely known to those who have elected to engage into shipping activities, there is a longstanding tradition and inherent belief, that all vessels navigating in close vicinity, shall assist when another vessel is in distress, however, and notwithstanding that noble tradition set-aside, such a duty is also regulated and can be derived from a number of International Conventions, thus rendering it a legal obligation for the owner and/or the manager and/or the carrier, to provide assistance to vessels under distress at sea.

Such conventions include inter-alia, The United Nations Convention on the Law of the Sea (UNCLOS), the International Convention for the Safety of Life at Sea (SOLAS) and the International Convention on Maritime Search and Rescue (SAR), thus, providing the platform and the legal framework on what is considered a distress situation and how that could be also covered insurance-wise, addressing the obligations of a vessel close in vicinity to a distress vessel, for the former to provide assistance, take on board, nurture and disembark those rescued to a refuge safe port, or alias, a safe place where they will be taken further care of and enable them to continue with their journey forward, whether same shall be to apply for asylum, economic or other shelter relief, to carry their lives onwards.

An important issue, thus, arises, on what shall be the eventual consequences for owners and charterers (as the case may be), in case they come across such a situation, whilst the Master and the crew must be vigilant not to render in parallel their vessel unsafe and/or jeopardize their own lives, as refugees that may require assistance could be a considerable number, which could raise various issues, mainly safety ones, the least being to prejudice cover or escalate costs.

It must be noted that such incidents can call for important decisions to be made very quickly, and although the first and spontaneous reaction for any prudent owner would be to take the distress call and assist in every way doable, such actions should be in parallel cautious and well thought of, so as not to lead and even create greater problems than the ones contemplated.

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Dealing with human beings in distress is the utmost sacred action one can envisage, thus, it is at least strongly advisable, for the risks to have been identified in advance and a plan to be in place, in case such a situation arises, based inter-alia on the capability of the vessel herself.

Trading in the Mediterranean especially, where the issue more often arises, many vessels in the past have already encountered situations where they are called-up by a Marine Rescue Coordination Centre (MRCC), or the relevant Coast Guard in any of the European Coastal states and are requested to participate in a rescue operation.

In most of the cases, the vessel taking the distress call, may have to deal with a situation of a small or larger boat, often unmanned, unseaworthy and crowded with people, wearing life-jackets who may not even work, desperately seeking assistance, ending-up with taking on board tens or even, hundreds of refugees aboard just one vessel, not manned with more than 20 crew members.

Such situations may prove very challenging, difficult and unique to deal with and one must be prepared to do the best out of it, taking into account, that medical, sanitary, as well as humanitarian and communication challenges may occur, as these people must be treated in the best possible manner, they must be nurtured and fed, whilst at the same time, the safety of the vessel's own crew must not be jeopardized.

Turning now to the technical issues and the cover from the P&I side, and leaving undisputed the clear obligation inherent to the mere essence of the maritime profession, which is to save lives and which can clearly provoke and trigger even criminal consequences if not applied, one has to be in parallel vigilant and aware in advance, which party has to bear the costs involved, bearing also in mind that a deviation is almost inevitable, and the underlying contract (time or voyage charter-party), will regulate the allocation of responsibilities, costs and expenses related to same.

The parties involved to such an equation, are usually, the owners, the charterers and their respective underwriters, namely their P&I Clubs. The allocation of costs will pretty much depend on the wording of the underlying governing contract, i.e. the charter-party, and its clauses, i.e. the wording embedded in same may shift the burden of such cost to the one party or the other or may even split it in the middle.

As is the clear P&I rule of thumb, the only expenditure which shall be indemnified to the assured, shall be the one which cannot and shall not be compensated by any other party.

In order for that process to be verified and validated, owners or charterers (as the case may be under the governing c/p), must initially explore the possibility for reimbursement to be provided by the competent authority which sought the assistance from the vessel in the first place (and subsequently instructed the vessel to provide) or the flag state where the vessel is registered under.

The costs for deviation are usually the most controversial and significant item in dispute, since changing route to assist and take the people in distress on board and then disembark them where instructed by the authorities, can fluctuate from a few hours to a few days, thus, bunkers, hire and time are all

questionable and contributing factors to building-up a considerable overall cost.

Such costs for deviation are usually covered by the P&I, subject to the deviation being made under reasonable grounds, which is usual the case, as distress calls are made from competent authorities, but this should not be taken for granted that the P&I silently adheres to it, the proper way to deal with it, is for the owners or the charterers (as the case may be), to inform their P&I in advance (as may be practicable and soonest allowable to do so) and clearly obtain advice, alias eventually, approval by the Club, so as to avoid even a scintilla of cover prejudice in any respect whatsoever.

In order to calculate the time and cost, one must presume that the event starts when the vessel responds to the distress call, changes her route and scheduled course, in order to attend and concludes when she resumes her original course and itinerary.

The costs and expenses that are normally covered under P&I for distress calls, usually include same for bunkers, stores and provisions, any additional port charges where the vessel shall call to disembark the refugees, pilots, port dues and other miscellaneous expenses, but always attributable and directly linked to the distress call event and not the ones that would have been incurred in the ordinary course of business should the distress call had not taken place. On top, any expenses incurred for nurturing, feeding, and alias, taking care of the rescued people, are all equally claimable.

It is to be expected that owners or charterers (as the case may be), will be asked to provide and disclose the full course of events leading to the deviation and the rescue operation, thus, they must have collated all relative evidence to support same (VDR entries, log books, witness statements, photos etc.).

Finally, it must be clearly noted that loss of hire for the deviation is not covered and shall not be indemnified under the normal P&I cover, but there are special insurance products developed in the industry, to provide additional cover to owners and charterers, on top of same.

Concluding, owners or charterers (as the case may be), must be always prepared in advance for such events and further must be taking all precautions at an early stage and before reaching the port of refuge, where the refugees shall be disembarked, in order to obtain clearance from the port, taking into account that once a vessel is calling a port with refugees on-board, she falls outside the routine regulations applicable to a normal call and is subject to the superseding authority of the harbour Master, the Coast guard etc. whilst P&I correspondents cannot really attend until all refugees have disembarked, thus, the appointment of a husbandry agent is strongly recommended to avoid complications and delays.

By Zoe Lappa – Papamatthaiou

The Hague – Visby Rules:

"*Strictly Speaking there are no such rules*"

These were the remarks of Lord Justice Tomlinson in Yemgas FZCO & others v. Superior Pescadores S.A. (2016) EWCA Civ 101 (*Superior Pescadores*) raising the finger to clause drafters to be more vigilant when they intended for the Hague Rules to apply to bills of lading instead of the Hague-Visby Rules.

The International Convention for the Unification of Certain Rules of Law relating to Bills of Lading were first adopted in 1924 and thereafter were simply referred to as the Hague Rules. They represented the first attempt by the international community to find a workable and uniform means of dealing with the problem of shipowners regularly excluding themselves from all liability for loss or damage to cargo. The objective of the Hague Rules has is (amongst others) to establish a minimum mandatory liability of carriers.

Under the Hague Rules the shipper bears the cost of lost/damaged goods if they cannot prove that the vessel was unseaworthy, improperly manned or unable to safely transport and preserve the cargo, i.e. the carrier can avoid liability for risks resulting from human errors provided they exercise due diligence and their vessel is properly manned and seaworthy.

The Brussels Amendments (officially the "Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading") in 1968, (colloquially known as the Hague–Visby Rules) introduced an alternative to measuring the limits of carrier's liability which in 1979 was eventually set to 2 Special Drawing Rights per kilo or 666.67 SDR per package or unit.

In the *Superior Pescadores*, the dispute related to a shipment of LNG machinery and equipment from Belgium to Yemen in January 2008. Six bills of lading were issued and each contained the well-known Clause Paramount which provided that the "*Hague Rules… as enacted in the country of shipment shall apply to this contract*". The cargo suffered damage during the voyage, resulting in a loss of USD 3.6 million. Cargo interests argued that contractually, the higher limit imposed by the Hague Rules applied to the bills of lading. The owners objected to this approach.

Although both sets of rules can be seen as related, they differ in many ways and more importantly in package limitation when it comes to cargo claims. In the market, when parties had to agree as to which Rules they wished to apply to their agreements, they either referred to the "Hague Rules" or the "Hague Visby Rules" to the exclusion of the other.

The Court of Appeal however held that both were in fact one single piece of law, despite the fact that 90% of the world trade is said to be covered by the Hague Rules. It held that the wording of the particular paramount clause incorporated the Hague-Visby Rules and not the Hague Rules. Historically and more importantly from a legal perspective according to English law, the former had been amended by the latter so that any form of differentiation in their name has been rendered redundant.

In the words of Lord Justice Longmore: "*Can it really be the case that a Paramount Clause in a contract made over 30 years later* (i.e. from 1977 – when the Hague – Visby Rules came into force) *in 2008 is still be to taken as incorporating the 1924 rather than the 1968 Rules?*"

By Michalis Papanikolaou

Heading towards Basel IV

Why do Banks need regulation?

The banking industry is directly related to the national and global economy and as such it is important for regulatory agencies to control them by setting standardized methods and regulations in order to minimize systemic risks associated with externalities (market failure), to correct other market imperfections, as well as to enhance consumer confidence.

The most important minimum requirement in banking regulation is the framework on how banks must handle their capital in relation to their assets. In 1988, the Basel Committee on Banking Supervision published a set of minimum capital requirements for banks that became law by the G-10 countries in 1992. A new set of rules known as Basel II was later developed as an amendment to Basel I, with the extension to cover market risks. The latest capital adequacy framework is the Basel III pursuant to which, the Basel Committee in response to the economic crisis in 2007 completed a number of critical reforms to the Basel II. Emphasis is being placed on internal systems and management of regulatory capital.

Basel III: An Overview

Banks did not have enough capital and will always choose to hold as little as possible to maximize the return on equity. The main issue in the reform process is to set the leverage ratio at a level to ensure banks truly have enough capital. Under Basel III, the regulators of the Basel Committee intended to increase the capital requirements for trading and compound securitization exposures. The latter is being the reason for the sector's most sizeable losses. The reforms are supported by a leverage ratio that operate as a backstop to the risk-based capital measures and are intended to constrain additional leverage in the banking system as well as to provide an extra buffer against model risk and measurement error. Additionally, the Committee with the Basel III reforms introduced a number of macro-prudential components into the capital framework to eliminate systemic risks arising from the interconnectedness of financial institutions. These include:

- Capital incentives for banks to use central counterparties (clearing systems) for OTC derivatives;
- Higher capital requirements for trading and derivative activities, as well as complex securitizations and off-balance sheet exposure;
- Higher capital requirements for inter-financial sector exposure, and
- **The introduction of liquidity requirements** that penalize extreme reliance on short term, interbank funding to support longer dated assets.

Strong capital requirements are essential for the stability of Banks but by themselves are not sufficient without a strong liquidity base through high supervisory standards. The Committee with Basel III introduced internationally harmonized global liquidity standards.

During the financial crisis, many banks - despite their satisfactory capital levels – were still struggling because they did not manage their liquidity in a wise manner.

These difficulties were due to gaps in basic principles of liquidity risk management. In response to this, the Committee delivered detailed guidance on risk management of funding liquidity risk and organized a tough follow up procedure to make sure that banks follow these fundamental principles. In addition to that and in order for the Committee to match these principles, they developed two minimum standards to achieve two separate objectives:

1. The Liquidity Coverage Ratio (LCR) to promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high quality liquid resources to stay alive in a critical stress scenario lasting for one month.

2. The Net Stable Funding Ratio (NSFR) to promote resilience over a longer term by creating additional incentives for a bank to fund its activities with more stable sources of funding and to offer a more sustainable maturity structure of assets and liabilities.

Basel III to Basel IV

The Committee has revised the standardized approaches under Basel III for reducing operational risk, market risk and counterparty credit risk and they have also worked more on reducing variability in risk-weighted assets. They also reviewed the overall standardization resulting from the combined revisions to the current model approaches.

These revisions include reducing reliance on external credit ratings, increasing risk sensitivity, reducing national discretions, strengthening the link between the standardized approach and the internal ratings-based (IRB) approach and enhancing comparability of capital requirements across banks.

However, the Committee recognizes a number of weaknesses in the current Standardized Approach. The most significant is the lack of responsiveness to different risk parameters together with variances in risk levels between different objects. Another noticeable weakness is over-reliance on external credit ratings and out-of-date calibrations.

As a result of the financial crisis, the demand on banks to supply external parties with appropriate information regarding their riskiness has increased. On the other hand, practically, there is a considerable distance at what banks report to external parties: Banks often use different definitions for the same model, as well as, the level and the details of risk are presented in different ways. All of these factors contribute to the state of opacity

surrounding current risk measurement of the Banks. In response, the Committee seems to have moved to a more standardized and more detailed risk reporting and data collection. In that sense, Basel IV is expected to place increased pressure on banks to gather accurate and detailed information on their counterparties and also will become more important the use of more standardized reporting and data management. Some implications of the revisions to the new Standardized Approach that may be viewed as a shift towards a Basel IV are:

1. The change of customer selection criteria by investigating the side-effects that may exist on an otherwise non-risk sensitive customer. Additional financial statement information will also be required regarding counterparties and the remarkably high penalizing risk-weight in case of missing information on them.

2. Reduce reliance on external credit rating agencies and a boost to the risk sensitivity of the exposures of Banks. External credit ratings agencies will no longer be a fundamental part of calculating risk-weight but they will be a part of economic assessments where they will be used for customer selection and pricing.

3. Increasing capital requirements for banks by changing internal models with the introduction of a minimum capital floor which has yet to be defined: meaning that capital requirements could not fall below a certain percentage compared to the standardized approach.

The above implications are confirmed by the Committee with the issuance of two consultation papers in December of 2015. The latter proposals are now relevant for all banks, since the revised standardized approach will be used to calculate a new capital floor for lenders that set up an internal-ratings-based (IRB) approach to quantify capital for credit risk. There is no target date for implementation and bankers hope the proposals will change beyond recognition before the final-rule stage.

Basel III in Shipping Industry

Banks are the traditional source of funding for the shipping industry. Basel III has raised the Banks' capital requirements and liquidity standards and as a result, the borrowing costs of loans. This affects negatively the borrowers (Ship Owners) as the new terms applied by banks' methodologies on loans' clauses for increased cost shift the additional borrowing costs on to the borrower. In addition, in order for Banks to arrange a better risk management under the Committee's regulations, they have tightened credit standards, enlarged the pricing spreads to cover their increased cost of capitals and shortened the tenors of their shipping loans to reduce the mismatch between the assets and liabilities on their balance sheet. Furthermore, shipping portfolios have long-term maturities that range on average from five to ten years in respect of banking institutions and it is noticeable that in the case of syndicated loans the amount of the facility may reach $500 million. This fact places the shipping industry at the center of the Net Stable Funding Ratio (NSFR) in Basel III, that sets a minimum amount of standard financing in respect of each bank, based on the bank's yearly liquidity over assets. Although the NSFR does not go into effect until 2018, banks have already begun to regulate their loan portfolios in anticipation of the NSFR effective date.

Shipping companies in response to this lack of bank financing due to the Basel III reform, have increased their activity in both debt and equity capital markets. The capital markets for shipping issuers have totally changed the capital structure, from high yield debt to preferred equity, with long-lasting and compulsory redeemable terms, to common equity of corporations and partnerships. Private equity has also played a key role in replacing bank debt, by providing the funds' investees with access to long-term high yield debt to sustain them through the investment horizon, enabling the investors to have the prospect of an eventual exit through a capital markets offering.

As the long-term financing is the desired goal in shipping loans, high yield bonds offer some structural benefits for shipping issuers. The high yield debt markets generally offer long-term debt with maturities extending from 5 to 10 years, and high yield notes are typically non-amortizing over the life of the issue. With regards to that, they offer the shipping issuer a theoretically stable capital base that matches long-term liabilities with the long-term assets in the issuer's fleet.

The Basel III framework has been criticized by the banking industry for the limitations in long-term lending, however it had a creative effect of introducing a more balanced approach to shipping finance.

By Lamprini Petrou