Turmoil following OW Bunker’s insolvency

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December 2014 – January 2015

The subsidiaries involved face insolvency following the uncovering a $125m fraud in Singapore and a $150m risk management loss.

This news has created turmoil in the bunkering market and has sent shockwaves through the bunker supply chain affecting physical suppliers and shipowners as a single bunker supply might involve numerous traders and one physical supplier holding an invoice issued to OW. An imminent second wave is expected as numerous suppliers will either cut their credit terms to a minimum or demand cash payment or a bank guarantee and numerous shipowners will face the risk of ship arrest for unpaid bunkers.

The creditors of OW are targeting either the fuel stored in the ships’ tanks or the ships supplied with fuel. On one hand, the bunker supplied to the ships represents one of their hopes of getting paid as most standard terms and conditions of bunker traders stipulate that the title in the bunker remains with the seller/supplier (creditor) until he is paid the full price of the bunker. On the other hand, ships are considered the common security in the maritime industry for unpaid bunker invoices.

OW Bunker has a presence in the UAE and is registered with the Dubai Multi Commodities Centre free zone (“OW DMCC”).

Since November 2014, Al Tamimi & Company has been approached by numerous players in the bunker industry in relation to the impact of the OW collapse, especially following the aggressive attempt of the creditors of OW DMCC to divert payments from the insolvent entity in order not to get caught in the body of creditors that will come into existence following the commencement of the liquidation proceedings of OW DMCC. In fact, the creditors of OW DMCC, namely the physical suppliers, are seeking payment of the outstanding amounts directly from the shipowners and are threatening to arrest their ships if they fail to make payment, which is putting the shipowners in a dilemma when faced with such request. In addition, other creditors are seeking to convince the shipowners to remit the price of the supplied bunkers directly to them by producing an assignment of rights from OW DMCC to them in relation to the supply.

Against this complicated background and from a legal perspective, the following two legal issues need to be addressed:

1. Can an unpaid physical supplier take legal action against vessels they supplied bunkers to through OW DMCC?

In principle, the level of exposure faced by shipowners or charterers who purchased bunkers through OW DMCC depends on the jurisdiction in which the arrest application will be submitted.

In some jurisdictions, the unpaid physical supplier that stemmed bunker through OW DMCC would not be able to arrest the ship due to the lack of contractual relationship between the shipowner and the physical supplier. The physical supplier has a contract with OW DMCC and the shipowner has a contract with OW DMCC which means that both of them have a claim against OW DMCC. However, a potential recourse may be possible if the physical supplier can prove that OW DMCC was acting purely as an agent/broker for the owner of a vessel. In this case, the courts would have to determine whether the ownership of the bunkers had passed on to the shipowner based on who has the authority to give the consent for it to be consumed.

The UAE Court of Appeal has recently (Appeal No. 399/2014) held that a sale and purchase contract of bunkers is implied between the shipowner and the physical supplier despite the completion of the deal through a trader. The Court of Appeal founded the judgment on the general principles of contract law relating to the formation of contracts and the fundamental maritime rule relating to the agency relationship between the shipowner and the master. In other words, the Court of Appeal underlined that since the master represents the shipowner and binds him in relation to the obligations emerging from the contracts entered by him within the limits of his lawful powers, the mere signature of the master on the bunker delivery receipt evidencing the supply of the bunker to the ship will create a contract between the physical supplier and the shipowner.

In addition, the physical supplier may be able to rely on the agency/brokerage provisions in the UAE Commercial Code to prove that the contract of bunker supply was concluded between the shipowner and himself and not between OW DMCC and the shipowner. In this context, the physical supplier will argue that OW DMCC was the broker for the supply and that he was representing him in the deal, specifically that the profit of OW DMCC constitutes the margin that will be added to the original price of the supplied bunker which is equivalent to the commission to which a broker is entitled. However, one must note that this argument was not tested in court in the UAE.

Against this background, it can be seen that there is a risk of ship arrest in the UAE.

2. Will an assignment from OW DMCC to the physical supplier entitle the latter to claim directly the price of the unpaid bunker from the shipowner?

The insolvency regime in the UAE provides for liquidations, bankruptcies and re-organisations which are governed by various laws (the Companies Law, the Commercial Code, the Civil Code and the Civil Procedures Code). The regulations (including the annulment of the insolvent’s acts) of each of these regimes differs from the other. In this context it must be noted that the legislation is largely untested in the UAE as there has yet to be major corporate insolvency volume.

In addition to the above-mentioned legal framework, we need to consider the DMCC Company Regulations No. 1/03 of 2003 since OW DMCC is registered in Dubai with the DMCC. Regulation 81.1 of the DMCC Regulations stipulates that the winding up of a company shall be made in accordance with the DMCC Regulations as if the company was a limited liability company formed pursuant thereto and may either be a summary winding up or by its creditors or by the Court under the UAE Commercial Code. OW DMCC has been recently placed into a creditors’ winding up process under Regulation 81.1.2.1 of the DMCC Regulations.

Pursuant to the above mentioned Regulation, a company may be wound up if the shareholders resolve so by resolution. Following the passing of such a resolution and within a period of fourteen days, the company must give notice of the resolution by advertisement in a newspaper prescribed by the Legal Registrar of the DMCC. In addition, the company shall call for a meeting of its creditors. The company and the creditors at their respective meetings may nominate a person to be liquidator for the purpose of the winding up. Within fourteen days after his appointment, the liquidator must give notice of his appointment to the legal registrar at DMCC and to the creditors (Regulation 81.1.2.1.5 of the DMCC Regulations). In addition, the creditors may appoint a liquidation committee consisting of not more than five persons to represent them and liaise with the appointed liquidator (Regulation 81.1.2.1.6 of the DMCC Regulations).

At the date of writing, the liquidation process of OW DMCC has reached the stage of the appointment of three liquidators and a liquidation committee.

Starting from the commencement of the winding up process in Dubai, OW DMCC ceased to carry on its business but maintains its corporate state and capacity until it is totally dissolved. In addition, the creditors of OW DMCC may not lodge any action against OW DMCC except by leave of the court. Therefore, the unpaid physical suppliers of OW DMCC are left with the assignment of rights that was provided to them by OW DMCC prior to its liquidation, entitling them to collect the price of the supplied bunkers directly from the shipowners/charterers.

The legal issues that arise relate to the validity of this assignment of rights in the UAE and its enforceability.

The UAE laws are not fully developed in relation to the assignment of rights. The UAE Civil Code only regulates the assignment of debts/obligations and is silent on the procedural aspects of an assignment of rights. Against this background, guidance on the validity of an assignment of rights must be taken from the UAE case law.

The UAE courts have defined the assignment of rights as an agreement between the creditor (assignor) and another party to whom the creditor transfers his rights (assignee) as against the debtor. The Courts have held that an assignment in that respect is a contract between the assignor and the assignee, which must satisfy all of the necessary elements including consent, subject matter and cause.

The Dubai Court of Cassation has held that for an assignment of a right to be valid and perfected, it must be notified to the debtor (who is a third party to the assignment of rights) and must relate to an ascertained and identifiable (in type and quantity) assigned right. In this context it should be noted that where the assigned right consists of a sum of money, certainty in the subject matter of the assignment lies not only upon the relevant contract (under which such right is being assigned) being identifiable, but also for that sum of money to be fixed at the time of perfecting the assignment.

Therefore, and in order for the assignment of rights given by OW DMCC to its physical supplier to be perfected in the UAE, the exact amount must be inserted in the assignment which is not the case in most of the assignments that we have reviewed.

However, and even if the assignment of rights is valid and perfected in the UAE, this assignment may be annulled by the creditors/liquidator at a later stage, which puts the shipowner at a great risk of being compelled to settle the same invoice a second time by the liquidator. Pursuant to Article 396 of the Civil Code, the creditor has the right to request from the court the declaration of any of his debtor’s dispositions ineffective against him, provided that the debtor’s obligations (whether due or deferred) exceed or are equal to his assets.

With the above in mind, and taking into consideration the chain of supply of the purchased bunker, shipowners may wish to refrain from paying physical suppliers directly without the intervention of OW DMCC, even if the latter has provided the physical supplier with an assignment of rights in relation to the supply.