The shipowner, the Cash Buyer, and the new European Regulation*

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Introduction

Cash Buyers provide a valued service to shipowners and to ship recyclers and this is why the majority of end-of-life ships are sold through Cash Buyers.

The shipowner sells to a Cash Buyer because of the latter's:

- intimate knowledge of the recycling markets;
- cash payment instead of payment with a Letter of Credit;
- ability to pay a sizeable deposit in cash; and
- risk mitigation for the shipowner, especially in a falling scrap market.

The ship recycler obtains the following from the Cash Buyer:

- access to the international shipping market; and
- acceptance of the recycler's Letter of Credit.

The role of the Cash Buyer is that of a commercial facilitator who facilitates negotiating letters of credit and also mitigates financial risk due to the dynamic nature of the currency and steel markets. Moreover, the legal responsibilities and obligations of a shipowner selling his ship to a Cash Buyer terminate at the time of the transfer of ownership.

The role of the Cash Buyer and his contractual relations with the shipowner and with the recycling yard will be subject to change when the European Regulation on ship recycling is fully applied to European flagged ships, in around three to four years time, and thereafter when the Hong Kong Convention (HKC) enters into force. This article provides a focus on these changes, and introduces an initiative comprising of adjustments to the sale process that are necessary for compliance with the European Regulation and the HKC, and/or for the voluntary implementation of improvements to ship recycling standards.

Drivers for change

Both, the new European Regulation on ship recycling and IMO's HKC define the Cash Buyer as a shipowner. The following text defines “shipowner” in the European Regulation, which is very similar to the definition in the HKC:

“ship owner" means the natural or legal person registered as the owner of the ship, including the natural or legal person owning the ship for a limited period pending its sale or handover to a ship recycling facility, …

In defining the shipowner in these terms, the regulators of both instruments have avoided to specify, or dictate, which shipowner (i.e. the operating shipowner or the Cash Buyer) will be responsible: for selecting an approved recycling yard; for finalising the Inventory of Hazardous Materials; for receiving the Ship Recycling Plan; for requesting the conduct of the final survey; and for delivering the ship for recycling in accordance with the regulations.

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Had the legislation tried to address separately the obligations of the shipowner and the Cash Buyer, it would have either resulted into impractically complex regulations (trying to capture all different ways and timings of selling and delivering a ship to the Cash Buyer), or into inflexible and thus restrictive arrangements (had the regulator dictated specific arrangements). Nevertheless, the consequence of merging and of not separating the roles of the operating shipowner and of the Cash Buyer is that the sale process is not defined in the regulation.

A further complication results from the change of ownership. Prior to the sale, the flag State has no power to enforce any requirements on the future owner, (i.e. the Cash Buyer). At the time of sale the ship must be de-registered by the seller and, from then on, the seller’s flag State has no further influence, nor interest, on the ship.

Most recycling sales are conducted on a “delivered” basis, whereby the change of ownership takes place at the anchorage of the recycling yard. Here, the Cash Buyer has no reason to register the ship under another flag, as she is not due to carry an international voyage. The HKC, as well as the European Regulation are silent on the question of the validity of certificates issued under the authority of the seller’s de-registered flag (Certificate on Inventory of Hazardous Materials, and Ready for Recycling Certificate), as, strictly speaking, certification issued by the seller’s flag becomes invalid on de-registration. IMO has agreed to consider this issue when it completes its work on the development of the guidelines to the HKC, with the view to issuing appropriate guidance. A practical solution could involve the recycling State endorsing and revalidating the expired certificates.

Quite a lot of sales are conducted on an “as-is where-is” basis, whereby the ship is delivered to the Cash Buyer away from the recycling destination. Here, the Cash Buyer has to crew, provision, fuel, reflag, and certificate the ship, usually under provisional registration. The HKC implicitly assumes that if a ship is sold on an “as-is where-is” basis and the flag State of the Cash Buyer is a Party to the Convention, the new flag will oversee the implementation of its requirements. If the new flag State is not a Party to the Convention, then the ship falls outside the scope of the Convention and there is nothing more to do.

Similar considerations arise from the European Regulation, as shown below:

a) Ship sold to Cash Buyer on “delivered” basis to:
   • a yard on the European List (compliance with the Regulation); or
   • a yard not on the European List (avoidance of the Regulation)

b) Ship sold to Cash Buyer on “as-is where-is” basis:
   • If the Cash Buyer re-registers the ship outside the EU then he can either:
     o sell the ship to a yard that is in the European List (compliance with the Regulation); or
     o sell the ship to a yard that is not in the European List (avoidance of the Regulation)
   • If the Cash Buyer re-registers the ship in the EU, he will have to sell it to a yard in the European List (compliance with the Regulation).
The first version of the European Regulation attempted to place an obstacle to evasion through re-flagging. The draft Regulation provided that ships, flying a European Union flag up to six months before being recycled in a non-approved yard, would face minimum penalties corresponding to the ship's value. During subsequent negotiations however, it was recognized that it is not feasible to keep a ship under European Union jurisdiction beyond its sale, and consequently the provision was removed.

**Shipowners’ dilemma and the role of the Commission**

The plain fact is that the HKC and the European Regulation are unable to guarantee their enforcement. The HKC offers more hope in the longer term, because accession by Bangladesh, China, India, Pakistan and Turkey would *de facto* ensure its universal enforcement, as hardly any recycling capacity exists elsewhere. Until such a global enforcement regime is established we have to recognise and accept that an owner of an end-of-life ship, who is not concerned about his reputation and any negative publicity generated by NGO activists, has, and will continue to have, the option of avoiding regulatory requirements for ship recycling. The same conclusion generally applies to Cash Buyers.

When we recognise that shipowners will have the option of avoiding or complying with the European Regulation, it becomes clear that the success of the Regulation will depend on the foresight and understanding with which it will be interpreted and implemented by the European Commission, who will have to avoid imposing unworkable or grossly disadvantageous requirements to shipowners who are considering the responsible recycling of their ships. In particular, the European regulator will need to understand the calamitous domino effect that will follow if it blocked the approval of South Asian recycling facilities simply because they utilize the beaching method. And because this will be a “make-or-break” decision, we need to keep it in focus:

- From a purely technical standpoint, ship recycling experts are very clear that there is no contradiction between good quality beaching, safety, and the protection of the environment.
- The last decade’s efforts to develop international standards for safety and environmental protection in ship recycling were motivated and directed by the needs of the developing countries in South Asia. It therefore makes no sense for the European Regulation to disassociate itself from making its positive contribution to where is needed.
- In South Asia, there are recycling yards that are currently implementing gradual improvements to safety, to environmental protection, and to social welfare. The owners of these yards need to be supported by the custom of quality shipowners, so that their businesses prosper and so that they become examples for imitation for other recyclers in their country and in competing nations. If these yards are ignored by the European Regulation, how will safety, environmental and welfare improvements be fuelled in the countries that need them most?
- If the Commission was to interpret the Regulation by banning beaching, they would discourage South Asian countries from acceding to the HKC, as, after all, it was mostly European countries that motivated its development and adoption. Without some of South Asia’s capacity, the requirements for the entry into force of the HKC cannot be met, torpedoing this way any prospects for successfully implementing any meaningful global ship recycling standards.
- China’s requirements for steel from ship recycling exhibit drastic fluctuations from year to year. In 2003 China recycled 35% of the world’s recycled tonnage.
In 2004 it recycled 21%, followed in 2005 by only 4%. In 2006 it recycled 6%, while in 2007 it was 8%. Then in 2008 it recycled 11%, followed by 31% in 2009, and in the subsequent three years by 25%, 24% and 22%. In 2013 for seven months Chinese yards hardly purchased any tonnage. If the European List was to rely on China without balancing capacity from say India, this will lead to periods of practically no capacity and unrealistic prices for any owners who want to recycle ships in line with the Regulation.

A ban to beaching will be not only morally wrong, but will lead with mathematical certainty to massive evasion of the European Regulation.

Conversely, if the European Commission does not go down the road of banning beaching, a significant number of owners of European flagged ships should be expected to adhere to and not evade the European Regulation. The actual degree of uptake of the European Regulation by shipowners will depend in part on the pricing differences that will develop between compliant yards and the non-regulated yards. If sufficient active recycling capacity is approved in the three geographic regions, pricing differences will probably be modest and accepted by many shipowners, thus providing more ships to the regulated market. This is a mechanism for change and improvement, whereby yards with the higher standards will receive a financial incentive, which in turn will entice other yards to strive towards responsible recycling.

The road to compliance

The shipowner who wants to recycle his ships in a responsible manner:

• can voluntarily do so now;
• if his ships fly an EU flag, he will be expected to comply with the European Regulation in three to four years’ time; and
• will be expected to comply with the HKC on its entry into force.

Owners who choose the route of responsible recycling voluntarily and under the regulatory requirements, will need to make an agreement with their Cash Buyer that ensures that recycling takes place as per the intended standards. In doing so, the Cash Buyer will have to accept and enforce contractual obligations that survive the change of ownership. These obligations would then have to be transposed by the Cash Buyer to the selected recycling facility, which has to be willing and capable to conduct recycling in the intended clean and safe manner. The shipowner and the Cash Buyer will also have to establish in their agreement who is responsible: for providing the IHM; for obtaining the Ship Recycling Plan; for the conduct of the final survey; and for delivering the ship for recycling in accordance with the regulations. Most importantly, they will need to agree how to select the recycling yard.

The Responsible Recycling Initiative

GMS is the world’s leading Cash Buyer, currently involved in recycling transactions covering around one third of all recycled tonnage. From this vantage point, GMS recognised that some of its clients need to ensure the responsible recycling of their ships. Accordingly, GMS’s Responsible Recycling Initiative is offered to shipowners who want to recycle their ships using the technical standards of the HKC before its entry into force. The elements of the Initiative can also be used to ensure that recycling is in line with the European Regulation. A brief summary of the key points of the programme is given below, while more details can be found in document: GMS Responsible Recycling Initiative.
The shipowner and the Cash Buyer

The shipowner and GMS will agree contractually whether the vessel will be sold either to a specified recycling facility, or to one that satisfies the required technical standards. The agreement will also address whether the owner or GMS will prepare the IHM; which of the two parties will provide it to the recycling facility for the preparation of the Ship Recycling Plan; and which party will be responsible for the final survey. The owner will retain contractually the right to request information and documentation regarding the progress of the work, and the right to inspect the facility to monitor that the recycling of his ship is performed as per the agreed standards. GMS will warrant that, on completion of recycling, it will provide a Completion Report giving evidence that recycling has complied with the agreed standards.

The Cash Buyer and the ship recycler

After the date of application of the European Regulation, and after the entry into force of the HKC, the selection of a compliant recycling facility should be straightforward. In the meantime, some shipowners choose to inspect a number of yards and then make a list of acceptable yards. Other shipowners restrict the recycling of their ships to, say, only Chinese yards. Some other shipowners simply require that “the ship is to be recycled in accordance to safe and environmentally sound ways”. Coupled to all these approaches, we have ISO certification as a tool for defining compliant recycling facilities. Another form of certification verifying that a yard is managed in line with the technical requirements of the HKC, is now being offered by a leading classification society and this appears to be a most promising way forward. Under the Responsible Recycling Initiative, the shipowner and GMS will agree how the recycling facility will be selected.

In its contract with the recycling facility GMS will warrant to provide the facility with the vessel’s Inventory of Hazardous Materials and the necessary plans for the preparation of the Ship Recycling Plan. The facility will warrant that GMS, and/or representatives of the vessel’s last owner will retain the right to: (a) be provided with the Ship Recycling Plan; (b) request information and/or documentation relating to the progress of the vessel’s recycling; (c) inspect the recycling facility at any time during the recycling process to monitor that recycling is being performed in accordance with the standards of the HKC; and (d) provide a detailed Completion Report giving evidence that the vessel’s recycling has been executed in accordance with the agreed standards.