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## 海運港口局助力香港航運業發展

Hong Kong's implementation of the SOLAS container weighing regulations - Do shippers have much margin for error?











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## Law Column -Hong Kong's implementation of the SOLAS container weighing regulations – Do shippers have much margin for error?

Shippers are now to comply with the SOLAS container weighing regulations which, from 1 July 2016 will require shippers to provide a verified gross mass ("VGM") of a laden container to the ocean carrier and port terminal. While this all seems straightforward enough, the Marine Department of Hong Kong ("MARDEP") has recently published a guidelines document which suggests that for those intending to use Hong Kong's thriving container terminal, it is not as simple as merely weighing containers by one of the two prescribed methods. Shippers need to consider how much margin for error these provisions really provide.

The MARDEP guidelines have added some much needed 'practical flesh' to the somewhat lean SOLAS bones. Some of the more important points of detail include the following:-

- MARDEP is the body responsible for enforcement of the legislation.
- For containers containing more than one shippers cargo, for the purpose of the Regulations, the "shipper" required to provide the VGM will be the entity that consolidates, seals and delivers the container to the carrier.
- The declaration of the VGM can either be signed manually or electronically.

## Rory Macfarlane, Nicole Tsui

- Prescribed wording for shippers Method 1 and Method 2 declarations.
- A VGM under method 1 (weighing the laden container) can only be obtained using a MARDEP approved weighing scale. All such approved weighing scale operators will be listed on the MARDEP website.
- A shipper intending to obtain the VGM via Method 2 (by weighing all the different components individually) must submit its proposed procedure for approval by the Marine Department and then apply for a shipper's registration. Guidance on what information is required for a Method 2 registration is available here.
- Shippers are entitled to a tolerance of +/- 5% for VGM's over 10 tons, (or a +/- 0.5 ton for VGM's of 10 tons and under).

This more strict adherence to the SOLAS Regulations being adopted by MARDEP can be contrasted with the US position, where the US Coast Guard has formally recognised a third "rational method" in addition to Method 1 and 2, whereby the shipper verifies the weight of the cargo and packing material, while the container tare weight is provided and verified by the carrier. If implemented, this would mark a significant departure from the regime envisaged by SOLAS which places the entirety of the VGM burden onto the shipper.

## The clock is ticking

The clock is ticking and many shippers remain unprepared and uninformed. We are seeing increasing reports of jurisdictional differences in the implementation of the Regulation. This will add to considerable uncertainty in the early days of compliance. Carriers and terminal operators should ensure systems and procedures are in place to deal with the cost and liability arising from failures to comply with the regulatory requirements.

## Steps that should be taken now include

• Inserting clauses into standard term contracts and carriage documents

to deal with cost and liability consequences arising from the new legislation.

- Terminal contracts should be reviewed to ensure they address how to deal with late declared / non-declared containers and non-shipped containers.
- Carriers should also try to raise shipper's awareness of these imminent changes perhaps with an announcement on their website or with reference to the Regulations and their implementation date in any booking confirmations sent out.

(Mr. Rory Macfarlane: Partner, Hong Kong Ms. Nicole Tsui: Solicitor, Hong Kong INCE & CO LLP International Law Firm)







香港特區行政長官梁振英在 2016年 施政報告中提出,特區政府決定整合現 時的航運發展局及港口發展局,成立新的 "香港航運港口局",4月1日該機構正 式運作。新機構未來的工作重點將以推動 人力培訓、進行市場推廣宣傳以及專注研 究發展事宜為主業,同時協助政府制訂策 略和政策,發展高增值航運服務業,提升 香港的國際航運中心地位和推動海運服務 業群的進一步發展。

人才培訓方面。航運涵蓋一系列不 同界别,包括航運保险、航運金融、省代 物流、航運經紀、航運管理、航運律師等 等。"香港海運港口局"應該清楚瞭解業 界不同類別的人力供應與需求的情況,推 動相關政府部門(運輸及房屋局、入境事 務處等)一起研究制定及相關航運人才的 聚集,發展規劃和培養引進計劃。除了支 援航運企業和機構通過市場機制從海內外 引進各類優秀航運業人才之外,建議"香 港海運港口局"主導制定合適的培訓措 施,比如政府可盡快設立涉及航運的職業 教育和培訓基地。在資金、場地、安排等 方面給予支持。香港背靠中國內地,可以 考慮與中國內地兩所最頂尖的海事教育機 構,合作創辦以香港為基地的 MBA 或者 EMBA 的培訓。香港理工大學目前設有物 流及航運學系,新機構應該積極促成其與 內地例如上海和大連海事大學以及世界海 事大學等專業航運院校增進交流並開展合 作辦學。內地、香港的教授與學生可以相 互學習、交流。儘管香港已經擁有很多高 端服務業的從業人員,如何吸引新鮮的血 液進來?如何保證現有人才持續高端?這 些都是新成立的"香港海運港口局"需極 力去推動的事情。

另外,香港海運港口局還可推動香港 城市大學法律學院下屬海事及運輸法研究 中心與香港的航運律師行、航運保險公司 等業界機構展開多層次交流與合作,資助 和培訓更多的專業航運法律人才。實現理 論與實踐相結合,提升香港在海事和運輸 法律方面的研究水準以及在航運法律教育 的國際影響力。

其次,研究發展事方面。建議海運港 口局應協助政府制定策略政策,通過參與 政策研究向政府提供全面和有的放矢的意 見,積極反映業界的聲音。

針對業界關心的問題進行專題研究 及時發佈研究結果,這樣才能提供政府及 相關航運不同企業和機構予以參考。讓政 策制定者和執行者能聽到,最終去影響和 執行、並代表業界給出最迅速的反應。香 港的港口輸送量下跌,雖然新加坡也面臨 同樣的問題,但是新加坡的港口和航運局 反應速度非常快,立即推出港口費優惠政 策,凡是靠泊新加坡港裝貨或者卸貨,如 果在5天之內裝完貨,給予10%的港口匯 率的優惠,反觀香港的步伐就慢很多,等 到採取動作時,船東已經轉向新加坡或者 內地其他港口。

最後,市場推廣宣傳方面。現在香 港已非處於酒香不怕巷子深的階段了。由 於香港不善於對自身航運功能的宣傳,留 給外界同行的印象始終落後於新加坡。但 事實並非如此,2015年10月由倫敦大學 瑪麗皇后學院(Queen Mary University Of London)公佈的國際仲裁調查中,香港被 評選為全球第三的仲裁地,僅次於倫敦和 巴黎。也就是說,除了歐洲之外的首選是

香港,而並不是新加坡。同時,香港還被 評為歐洲以外仲裁地的首選,以及過去五 年內發展速度第二快的仲裁地。去年11月 香港國際仲裁中心 (HKIAC) 在上海自留 **福開設代表處,成為第一家在中國內地開** 設代表處的境外仲裁機構。而其他全球領 先的仲裁組織也於近幾年相繼在香港設立 辦事處或仲裁中心,包括國際商會國際仲 裁院、中國國際經濟貿易仲裁委員會和中 國海事仲裁委員會等。新加坡成功利用其 自身的宣傳,繼紐約、倫敦以外,成功獲 得波羅的海的爭議解決條款仲裁地的第三 候選席位。試想,經年累月的宣傳,新加 坡港口發展的確又很迅速,很多船東和航 運相關企業都會選擇去嘗試。香港新成立 的 "海運港口局" 應當著力攜手航運及港 口業界共同合作。"推廣香港國際航運中 心地位及航運服務",光有機構還不夠, 必須和業界和其他相關的產業一起合作推 **廣。例如,香港已經連續舉辦了五屆亞洲** 物流及航運會議,新機構在成立之後應該 以更加主導的姿態來主持會議安排規劃和 日程,凸顯專業性,吸引全球更多航運物 流業界人士參加會議。

另外,海運港口局還應該在國際航運 事務上與內地一起積極發聲,在維護香港 航運海運利益的同時,借力中國參與和完 善現有的國際航運規則和秩序,甚至制 定未來國際航運發展的新規則。中國現在 不僅僅是國際遊戲的參與者,同時也希望 成為國際遊戲規則的制定者。國家成立亞 投行,提出"一帶一路"策略等等,這些 都是我們參與制定國際遊戲規則的步驟之 一。香港要在瞭解國際航運遊戲規則的基 礎上,通過自己的專業知識為國家"走出 去"提供建議。

遺憾的是,"香港海運港口局"並不 是早前設想的法定機構,還有待運作一段 時間,並參考實際經驗及解決經費、可持 續發展等問題後,才會探討轉為法定組織 的可行性。政府既然明確要提出建立新的 海運港口局,就應該切實去做一些事情。 衷心希望新的海運港口局不是"舊瓶裝新 酒",純粹為了成立而成立,而是真的實 現整合效應為推動香港航運和港口業發展 做出實際貢獻。

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(劉洋先生:香港禮德齊伯禮律師行註冊 外地律師、2015年首屆十大傑出新香港青 年)





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## Current Status of Global Shipbuilding Industry and Korea's Global Leadership in Shipbuilding and Offshore Industry. (Part II)

## Sung Hyuk Hwang

## (continued from Part I)

Drama went on. It was the drastic fall in the oil price during the second half of the year 2014. The oil price more than halved all of a sudden. The offshore industry suffered the most when the oil price fell. To rationalize the immense investment made at the deep-sea oil field, crude oil price has to be around \$100 level, and \$40 to \$60 level could not justify them assive deep-sea exploration cost. Clients who were friendly when the market was good, became harsh to the shipyards. They started to pick on everything to delay the date of delivery and levied them penalty to cut the final contract price. Although penalty itself was burdensome, interest on the projects due to the delay in delivery was another burden. Some also tried to cancel the contract by delaying the delivery date intentionally. The Korean shipbuilding industry that began with HHI during the early 1970s recorded major deficit for the first time. This was considered as the critical blow that cannot be recovered.

Let us see why the offshore project became such a nuisance. Offshore project and shipbuilding project are fundamentally different. As for the shipbuilding, shipyards supply and design all the parts and systems to complete the ship. When a ship complies with performances specified on the contract, shipowner assumes the responsibility to take the ship. On the contrary, offshore project is a contract in a form of EPC, engineering, procurement and construction. Various forms of change orders take place in each stage, when clients are expected to intervene. Thus, there is a good possibility that the contract will be unfair to shipyards to take unlimited responsibility while they have limited rights to make a choice. During the engineering or construction stage, client's requirement is factored in significantly. Furthermore, for the maker's list the client selects, shipyards assume unlimited responsibility for them, even for those that they are not familiar with. Difficulty faced by the shipyards on EPC contract changes significantly depending on the client's attitude. When the client cooperates with the shipyard, project is carried out effectively and shipyard's operation becomes smoother. However, when the client starts to pick on everything and levies all the responsibilities to the shipyard unilaterally, shipyards become cornered by their oppression. When the employment is uncertain after a project is completed since the offshore industry itself is shaky as with current cases, the oppression from client becomes unbearable. Likewise, the considerable deficit of the Korean shipbuilding yards is not so much due to their own fault, but it is more of a "Market Claim" starting from market slump.

Aggravation in the offshore industry and client oppression scorched the global shipbuilding industry. Korea's Big 3 that had some negotiation power, started to raise voice for their opinion since this was bound to lead to the collapse of not only the shipbuilding industry but the offshore industry itself, if this situation continues on as is. With Korea's Big 3 taking the lead, the classification societies, oil majors, and offshore specialized engineering companies in the world met to start the "offshore plant specification standardization" work. Until now, specifications for the required materials and designs were all different depending on the client and the project. Moreover, design, production and quality control processes were all very different. So it was not possible to forecast the purchasing price of the required materials and the material procurement, and the process control were complex. The standardization was to cover all the processes of the EPC contract. Especially, three areas were pursued; material standardization, design standardization that entails unifying the project progress and material produced by outsourcing and process standardization that applies the procedures that were unified in terms of the design, production and quality control. This standardization work alleviates the problems such as unpredictable production cost and delay in process. This becomes an essential procedure for strengthening the competitiveness and will contribute significantly to the lowering of the entry barrier for the domestic offshore equipment companies. This type of standardization will increase the global offshore industry's reliance on the Korean shipbuilding industry, which will enhance Korea's market leadership.

What is even more urgently called for while offshore plant's technical standardization is worked, is the standardization of the contract to simplify EPC's legal structure. Even when technical side is stabilized after the technical standardization work is completed, onesided unfair contract will continue if the rights and responsibilities for each process and stage are not established fairly. The work that entails drafting standard contract on the rights and obligations among the clients and shipyards, when it comes to all the "change orders", is a priority task needed for the industry's long term plan. Drafting the technology standardization and standard contract will enable to estimate the construction cost and minimize the conflict between clients and shipyards, stabilizing the future of the industry. This whole procedure needs to be led by Korea's Big 3 and the market leadership of the Big 3 will be strengthened in the end.

Every time the market faces difficulty, it creates a niche on its own. In 2008, the offshore industry emerged when shipbuilding industry was on the verge of collapse. The offshore facilities that shipyards had not paid attention to due to its complexity and size during the boom period, emerged fast when the shipbuilding market was stalled. Expensive Drill ships, FPSOs took up the key berths of Big 3. Production of the US Shale gas changed USA into an energy export country and encouraged construction of LNG ships all over the world. Also, competition started among the container operators for the ship enlargement and that demand became a good source of work for the shipyards. The Big 3 ignored the regular merchant ships that needed fierce competition with China. The shipyards in China and Japan, and the medium sized shipyards in Korea took in the orders and filled up their berths with the regular merchant ships that were ordered occasionally.

Meanwhile, the market was preparing for yet another drama amid the steep decline in the price of crude oil price. This sharp decrease in oil price not only hit the shipbuilding industry with the order for offshore project stopped, but also destroyed shipowners' will to build new ships. Fuel cost takes up 70% of all the operation cost. In the age of high oil price, shipping companies are bound to build new ships with the latest fuel-saving engine and state-of-the-art hull design in order to save even one drop of fuel, bringing old ships to scrapyards. However, as the oil price declines, demand for new ship decreases since it is more economic to operate the old ships with low priced oil rather than investing significant sum to build new ships. However, oil price decline was creating a subtle balance. It was the Contango demand. For instance, oil is purchased today at a price level that is significantly lower than the supply price of the volume to be supplied in the following year. This oil is stored in the oil tanker, until it is supplied at a set juncture of the following year. Since old ships were used for storing, this created significant demand for new shipbuilding for the immediate transport. This is why many oil tankers were constructed this year. There was yet another niche. To prevent atmospheric pollution, International Maritime Organization (IMO) decided to apply the regulation on the nitrification gas discharged from the ship starting from the ships that are subjected to the Keel Laying after January 2016. In order to avoid this regulation, provisional demand was created, filling up the berths of many shipyards. Breaking the forecast that new orders for shipbuilding could face significant difficulty early this year, many shipyards were able to secure their berths until 2017 due to the niche kindly provided by the market. Of course, it is necessary to consider the other side of the niche. The contracts for the newbuilding of regular merchant ships are bound to slow down for a while after the Contango situation and after the effectuation of the IMO regulation. In 2016, we expect yet another niche to emerge.

I have addressed the current status of the global shipbuilding market and the problems faced by the market. Now, situations in China and Japan will be reviewed and the future of the Korean shipbuilding industry will be discussed.

In outward appearance, Chinese shipbuilding industry expanded significantly with the advent of the 21st Century. Over 2000 shipbuilding companies were registered. At Zhejiang area, so called beach yards were newly formed everywhere, by river or beach. They were building ships placing on concrete blocks in the waterside sandy plain, devoid of dock or slipway. The shipyard owners believed that they could "make huge amount of money only by hanging a shipyard signboard." They looked prosperous during the boom period. However, those places became a desolate beach that was swept by wave after a festival. Now, there are not even 800 shipyards with their signboards and there are less than 40 shipyards that have actually won even a single order to build a ship in 2015. Bulk carrier, which was the main category for the Chinese shipyards, recorded the lowest ever freight rate due to excessive supply, and inquiry for new ship stopped. Ships that are being constructed by shipyards are being converted into other ship types or the contracts are being cancelled. When the deep-sea crude oil exploration became active, demand for the ships to support the exploration had been largely increased. Hundreds of PSV (Platform Supply Vessel) and OSV (Offshore Supply Vessel) ships were ordered. These ships did not require significant technology and the orders mostly went to Chinese shipyards that were considered easier to negotiate for lower ship prices. Shipyards, that did not have work, took orders at the worst contractual terms and some shipyards built ships with their own account without a contract, expecting that the demand for these auxiliary ships will increase significantly in the future. The contracts for about 200 PSV vessels that were signed during the short boom time were cancelled and completed ships were moored outside of the shipyards. About 100 ships that were under construction were stopped and media said that they "will never hit the water." In the end, the government intervened. So called White List was made to select 50-60 shipyards and announced the plan to focus on the capital support for them. Shipyards that are not in the list are expected to be reorganized in near future. However, the natural strength of the shipyards that were rescued with the government's support is likely to become a question for their survival in the future.

Japan wholed the global shipbuilding industry during the 1960s began to dwindle along with the growth of the Korean shipbuilding industry with the advent of the 1980s. They began to say, "This is the time to take hat off and bid farewell to the industry." Then, they lost the No. 1 position to Korea starting from the 1990s and took the back seat. But, they did not give up the industry itself. Many Japanese shipyards secured significant volume since most of the local shipowners wanted to build ships speaking only in Japanese instead of conversing in a foreign language. The boom that started from 2003 did not help them to fulfill their appetite. World class shipyards like, Mitsubishi, Mitsui, Kawasaki and others were downsized. Only Imabari made sizable growth by absorbing small to medium sized shipyards. The Japanese economy's "lost 20 years" affected the shipbuilding industry significantly. Shipbuilding industry is considered a bygone industry. Shipbuilding department disappeared from top universities and related jobs are considered unpopular among youngsters. After the weak Yen policy enforced under Abe regime's Abenomics economy, shipyards' price competitiveness improved drastically. However, Japan is not in a position to accommodate the boom, due to the limited facility and shortage of technical manpower. Moreover, sustainability of the boom is not trustworthy since it is a phenomena supported by the government's Yen policy.

After Hyundai Heavy Industries entered the global market in 1972, Korean shipbuilding industry continued to enjoy profits while effectively taking advantage of the market ups and downs. Proper investment was made in the production facility and the technical personnel are being supplied steadily from the universities. The Korean shipvards have built sufficient competence with the energy and technological capability accumulated during the market ups to tide over the market downturns. Although mid-sized shipbuilding yards are experiencing hardship since 2008, they are not traditional shipyards, as they were block fabricating companies that transformed into shipyards during the shipbuilding boom. Their facility can be used as auxiliary shipbuilding facility once again. Korea's Big 3 are the last bastion to protect the global shipbuilding, offshore and shipping industries. The Big 3 are the last break water that can defend the industries against severest tsunami. The reason why tough worldwide offshore operators are cooperating with Big 3 for technology standardization and considering rational reform in EPC contract, is because there is a consensus that Korea's Big 3 should not be damaged any longer in order to prevent the co-destruction of the global industry. Imbalance in the supply and demand of the regular merchant ship is expected to continue for a while. Accordingly, industry's difficulty will continue as well. The Big 3 are the only ones that can withstand this difficulty on their own strength. Hyundai and Samsung have the ability to withstand any difficulties. Although Daewoo is experiencing tough times, its LNG technology is an asset that the world covets, especially Middle East and Russian authorities, continues to express their will to purchase it. Investments in the offshore industry have stopped. However, it is not

possible to leave the offshore facility on hold. Oil-producing nations cannot insist on the low oil price for long. Experts predict that investment in the offshore industry is likely to resume after the end of 2017. At that time, only Big 3 can accommodate the worldwide demand with both technicality and production capacity. Only the Korean shipbuilding industry can benefit from the market ups and to accumulate competence. The Korean shipbuilding industry should not be shaken by one month or year-long downturn, and should be prepared for the future with firm confidence and pride as the Global Leader.

(Mr. Sung Hyuk Hwang: President, Hwang & Company Ltd.)









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## 談談本地船員的航海訓練

一艘外洋船抵港,在南丫北錨地抛錨 裝卸貨物。本地躉船靠泊,裝卸外洋船的 貨物。外洋船的船員要上岸/回船,需要 靠細小的本地船隻接載。我們可有想過本 地船員的資格或勝任能力如何?法例要求 本地船長和大偈,只需要符合法例規定的 要求即可。

海事處聘用的船員,只需要小學畢業 程度, 諳泳術並能在沒有輔助的情況下一 次過游畢 50 米。由小輪助理員(即水手) 做起,具多年經驗後,可安排學習[三級 本地小輪船長和大偈],並加以訓練,考 試合格後可擔任三級小輪船長和大偈。再 具多年經驗後,可安排學習[二級小輪船 長和大偈],考試合格後可任高級小輪船 長和大偈。又再有了足夠的海上經驗,可 安排學習[海上急救、海上消防和海上逃 生]課程,然後可以申請成為一級小輪船 長或大偈。由小輪助理員至一級小輪船 長,前後共需差不多二十多年。

持有一級本地船長或大偈牌照後,有 雄心的可嘗試挑戰內河船的考試,有機會 成為內河船長或大偈。考試合格後,程度、 薪水和前途便可大大不同了。

船公司負責人招聘合資格船員時,常 遇到困難。為此,海運學會創辦人之一朱 志統船長曾建議,將本地船員提升至內河 或遠洋船員(見海運季刊第109期[2015 年春季]和第111期[2015年秋季])。這 是非常好的提議,亦即本地船員可由本地 船隻,做到遠洋船隻。 訓練本地船員的師資又何來?前香 港理工學院航海系的講師多來自英國或印 度,所以本地學員英語能力都可提高。現 時,入行的海員人數愈來愈少,導致本地 導師也愈來愈少,也引致教學上的困難。

本地的船東很容易聘請到勞工型的 海員,尤其是不需要牌照的工種,只要有 人願意幹,船東就可聘用。現在船東注重 到該勞工是否適合在船上工作,有沒有船 方技能。什麼是船方技能?那就是聘請水 手,要識水手的工作,即是要給新人遇適 當的訓練。

海員結束航海生活,上岸工作的前途 是很好的,可供選擇的工作,包括領港員、 船公司和相關公司的專才、海事處人員、 海事律師、海事訓練、內河或本地小輪船 員,甚至管理人員等。

全球九成以上的貿易,需靠水路來運 輸貨物。因為船隻數目太多,而且船隻體 積越來越大,全球已經大量缺乏海員,香 港應盡早訓練多些海員,使航海界不致出 現斷層。

(林傑船長: Master Mariner, M.I.S., MH.)

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## ICSHK Column -Commercial Aspects of Shipping

## "Commercial Aspects of Shipping – Market Dynamics – Part 2"

Continued from the part 1, where we looked at theory of trade, absolute and comparative advantage theories, demand for shipping followed by actual supply, demand curves and resulting utilization. In this article, we will look at the demand and supply modeling followed by determination of equilibrium freight rates. The material used in this article is adapted from ICS Tutorship and those interested to learn more about the subject may consider pursuing the qualifications examinations leading to Foundation Diploma and/or MICS (Member of Institute of Chartered Shipbrokers).

The bulk dry trade, from Handy to Capesize, is taken as an example. The analytical framework developed here can still be applied to other segments as well, provided that they satisfy the following assumptions (basically for a "close" to "perfect competition" scenario): -

- 1) Each shipowner company is seeking to maximise their profits, (or minimise their losses).
- 2) Each charterer is seeking the cheapest rate consistent with an acceptable quality of service offered by the shipowner.

3) There are a large number of fixtures (deals done), the details of most of which are readily available to all market participants (i.e. we have good information of the market transactions to guide us).

Jagmeet Makkar

 The model of perfect competition is assumed to be an appropriate framework for analysing market behaviour.

## **MODELLING DEMAND**

The individual shipper's firm requiring transport/shipping services regards the freight rate as a given value which they cannot alter through their own individual action. It is assumed that there is a downward sloping relationship between the cargo volumes required to be moved and the level of freight rates, other things held equal. The higher the rate, the smaller the demand for cargo movements, and vice versa.

Will market demand be very responsive, or very unresponsive, to a change in the freight rate? Both are possible and consistent with a downward sloping relationship between rates and cargo quantities. The demand for dry cargo tonne miles (multiplication of tones carried over a distance in nautical miles) is a *derived demand*.

The principal underlying the estimation of price elasticities for derived demands are:

- 1) The value of the own price elasticity of demand for the final good.
- 2) The existence of close substitutes
- 3) The proportion of the total final price which transport constitutes.

Take grain as an example. Grain movements are driven by production and consumption trends in different regions, by local weather conditions and crop yields, and by changing patterns of food consumption. Grain is itself an input; it is used to make bread or pasta, or fed to animals to produce meat. But bread, meat and pasta all *have low price elasticities* of demand. Most empirical evidence suggests that they are price inelastic.

Grain movements from major exporting regions such as North America have to go by sea. Air transport, whilst feasible for small volumes, is a very expensive alternative.

Historically, freight rates are about 5% of the final price of most traded commodities. The situation is different these days due to unprecedented high freight rates being witnessed and they may

be much higher than 5% and in case of low price commodity such as cement, it could be more than the cost of product itself.

The conclusion is that, taken as a whole, market demand is likely to be extremely inelastic with respect to changes in freight rates. The demand curve can be represented as an almost vertical line, as in Figure 1 below.

Note that this conclusion is for the market as a whole. It does not follow that demand conditions on any one trade route are also necessarily inelastic. It could be the case that the possible sourcing of demand from other countries and other routes makes the demand on each route much more sensitive to changes in the specific route's freight rate; indeed, owners will always be seeking out trades/routes which are more profitable than others. But the ability to switch vessels' from one route to another at relatively short notice implies that rates should not get too out of line with each other (allowing for genuine differences in costs between routes of course); and indeed, the behaviour of individual freight rates suggests that this is indeed the case.





Freight rates are measured on the vertical axis and quantity of the commodity (or cargo tonne miles) are measured on the horizontal axis. D1, D2, and D3 show three different demand schedules, each further out to the right. These represent different volumes of demand, generated by higher and higher levels of economic activity, industrial production, or world trade volumes. A fall from D2 to D1 would represent a decline in tonne miles demanded, or cargo tonnes moved. A rise, or shift of the demand schedule from D2 to D3, would represent the long term expectation.

In some periods of the demand cycles, the demand schedule will be shifting rapidly out to the right, reflecting boom conditions (such as seen since 2003); in other years, it will be hardly shifting at all, and perhaps even declining.

Over a long time period, it is anticipated that the trend will be a shift out to the right.

## **MODELLING SUPPLY**

Under competitive conditions (and given a choice), theoretically the shipowner should never accept a freight rate that is less than the average variable cost of the ship's operation. Different ships have different costs, because either they are of different ages, or because they operate under different flags, or face different wage costs.

Imagine that all these costs were known, and that a ranking could be organised, starting with the dry cargo bulk vessel with the lowest average variable cost, moving up to the next, and so on until the last, most expensive vessel is brought in. If the freight rate were high enough, and cargo volumes large enough, all these vessels will be employed. Now imagine the freight rate or charter hire is steadily reduced. Which vessels will cease trading first?

The answer should be clear; those with the highest variable costs. As the rate is remorselessly lowered, more vessels are forced into idleness, until none are trading (close to 225 million deadweight of tonnage was laid up in early to mid eighties due to this reason. The author, as a third engineer, was looking after three laid up vessels off Trincomalee in 1984 along with a second officer and a cook). Furthermore, the capital costs should play no role in the lay-up decision in the short run, since these costs have to be met whether or not the vessel is being traded. Older vessels will tend to have higher operating costs than newer vessels, partly because they will be designed with older, less efficient equipment in place, partly because they will require greater crew numbers than modern ships, and partly because they may have older, more fuel inefficient engines. It is not surprising then, to observe that the majority of laid up vessels are the older ones of the fleets.

The shape of the supply schedule is drawn here for reference in figure 2. It is drawn so that it becomes steeper in slope as maximum tone mile production is attained. There are two reasons for this. Firstly, the additional tonne miles being created near 'full capacity' are being created by the more inefficient vessels in the fleet, the ones with higher variable costs. These vessels add a lot to costs without adding that much extra to output. Secondly, speed increases are a limited way of raising output. The extra costs of fuel consumption increase more rapidly than the extra output, so the required supply price increases.

The curve eventually becomes vertical, representing the notion of full capacity utilisation. *No more output can be obtained from the existing fleet, in the short term.* 

In the language of economics, the supply curve represents the additional, or marginal costs, of meeting the extra output required. This proposition is only valid if the market is itself competitive.





## DETERMINING THE EQUILIBRIUM FREIGHT RATE

The market is defined as the interaction of supply and demand, which both together determine the equilibrium freight rate and quantities sold at that rate. Figure 3 below shows several different possible short run market equilibrium, each determined by different demand conditions. The key factors that make demand conditions alter relate to the volume of world trade, which is driven by overall economic activity, and changing degrees of openness towards trade by individual nations. Demand curves further to the right represent larger trade volumes.

## Figure 3 Short Run Market Interaction



Demand volumes increase from D1 to D4. Between D1 to D3 there is a relatively small rise in the market freight rate and a large rise in tonne miles produced. But between D3 and D4, the increase in demand is translated into large increases in rates, because supply becomes very inelastic, and the scope for increases in supply becomes increasingly limited.

The above model can be used to examine short run fluctuations in market conditions, but not long run ones. This is because the supply schedule represented in Figure 2 and 3 is drawn for a given stock of ships. It is a useful framework to explore fluctuations in freight rates in the short term however.

Consider the shift in demand from D3 to D4. Rates move up very sharply, and supply does not increase much. This creates large profits for existing shipowners, who will be encouraged to order new vessels. The value of existing vessels will also rise, reflecting the markets' expectation

that profits are going to be healthy in the future. The increased number of orders will translate into a rightward shift in the supply curve in the long term, and this will lead, to a fall in rates if demand remains at D4.

On the other hand, a fall in demand from D2 to D1 means a fall in supply and a rise in vessel lay-ups. Remember that in the short run, some vessels will be trading at rates which do not cover their full costs. While this is acceptable in the short term, it is not the case in the longer term. Some vessels will be laid up, or scrapped. The scrapping of vessels leads to a leftwards shift of the supply curve. This process will help raise rates if the supply shifts far enough.

## to be continued ...

### References:

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The views expressed here are solely those of the author, and do not necessarily reflect the views of the organization he represents.

(Mr. Jagmeet Makkar: FICS, FRINA, FIMarE (I), MCIArb Past Chairman, Institute of Chartered Shipbrokers, Hong Kong Branch)



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## AA TALK

The York-Antwerp Rules 2016 -Major changes from the York-Antwerp Rules 1994

As anticipated, at the CMI Conference in New York on 6<sup>th</sup> May 2016 the York-Antwerp Rules 2016 were adopted, which seem to largely reflect the York-Antwerp Rules 1994 which has been widely incorporated into contracts of carriage disputes; while a more recent 2004 revision has remained largely redundant, being considered less favorable to ship-owners.

The Assembly of the CMI also adopted the "CMI Guidelines relating to General Average". The relevant documents can be downloaded from the CMI website: www.cmi2016newyork.org/session-1

It is noted that BIMCO, the world's largest international shipping association, has already agreed that their standard documents will be amended to reflect the new rules, YAR 2016. Accordingly, we consider it advisable to highlight the major changes from the YAR 1994, noting that the minor changes include an amended numbering system and greater consistency in the terms being used.

## **RULE B**

YAR 2016 provides a clearer requirement for the "disconnection" to be a general average act in the tug and tow cases, as noted in paragraph 2: 2. If the vessels are in common peril and one is disconnected either to increase the disconnecting vessel's safety alone, or the safety of all vessels in the common maritime adventure, the disconnection will be a general average act.

Paragraph 3 provides a brief introduction concerning port of refuge expenses. It is submitted that if the tug and tow are detained at a port of refuge whilst repairs to the tow which are necessary for the safe prosecution of the voyage are effected, the port charges, crew wages, maintenance and fuel and store referable to the tug will be allowed in general average. Equally, if the detention is on account of repair to the tug, the port charges during the period of detention (and the crew wages and maintenance of the crew if she has one) referable to the tow will be allowed in general average.

## RULE E

Rule E of YAR 1994 allows the parties to give notice of a claim in general average within 12 months, measured from the date of the termination of the common maritime adventure and provides for the average adjuster's liberty to make an estimate of allowances or contributory values upon expiry of the 12 months of his requesting for such evidence and particulars. The adjuster's estimate may be challenged only on grounds that it is manifestly incorrect.

Rule E of YAR 2016 provides a clearer time-line for the provision of documents and evidence with the intention to help speed up the adjusting process, and paragraph 3 allows:

- a) For notification and particulars in support a claim – 12 months from the termination of the common maritime adventure or payment of the expense;
- b) For particulars of value 12 months from the termination of the common maritime adventure.

The parties are allowed to challenge the adjuster's estimates within 2 months of receipt of same.

Paragraph 4 of YAR 2016 is a new provision that any party pursuing a recovery from a third party shall advise the average adjuster and supply full particulars within 2 months upon receipt of the recovery achieved. The adjuster should take note ensuring that any allowable credit to the general average is made in the appropriate manner.

## **RULE G**

Additional words are added in the last paragraph of Rule G:

4. The proportion attaching to

cargo of the allowances made in general average by reason of applying the third paragraph of this Rule shall be limited to the cost which would have been borne by the owners of cargo if the cargo had been forwarded at their expense. *This limit shall not apply to any allowances made under Rule F.* 

It will help resolve an area of uncertainty and differences in average adjusting. The following example illustrates the working of the "cap":

- Vessel with cargo on board sustained propeller damage and was towed into Port of Refuge A;
- In order to do repairs necessary for the safe prosecution of the voyage, it would be necessary to discharge, store and reload cargo;
- Instead, cargo is discharged and then forwarded to destination;
- Vessel is towed to Port of Refuge B (where there are the necessary repair facilities) and effects permanent repairs;
- Ship and Cargo are 20/80% respectively of total values;
- It would have cost Cargo US\$350,000 to have arranged for its own carriage to destination.

			Gene	General Average			
GA "proper" (up to completion of discharge at Port A)				500,000			
Extra forwarding charges, i.e. net of							
per Rule F		300,000					
			US\$	800,000			
GA allowances under the "Non-Separation" parts of Rule G							
paragraph 3				500,000			
			US\$	1,300,000			
Cargo's contribution:							
80% of GA "proper", US\$800,000		US\$ 640,000					
Rule G paragraph 3	US\$ 500,000						
Of which, 80%	US\$ 400,000						
Limited to		350,000					

It is worth noting that the unrecoverable part of Rule G paragraph 3, (i.e. US400,000 - US350,000 = US50,000) is recoverable under English law (per "ABT Rasha") from H&M Underwriters. The position under other jurisdictions is less clear.

### **RULE VI. SALVAGE REMUNERATION**

The wording of Rule VI paragraph b) is new to the YAR 2016:

- b) Notwithstanding (a) above, where the parties to the adventure have separate contractual or legal liability to salvors, salvage shall only be allowed should any of the following arise:
  - (i) there is a subsequent accident or other circumstances resulting in loss or damage to property during the voyage that results in significant differences between salved and contributory values,

350,000 US\$ 990,000

- *(ii) there are significant general average sacrifices,*
- (iii) salved values are manifestly incorrect and there is a significantly incorrect apportionment of salvage expenses,
- (*iv*) any of the parties to the salvage has paid a significant proportion of salvage due from another party,
- (v) a significant proportion of the parties have satisfied the salvage claim on substantially different terms, no regard being had to interest, currency correction or legal costs of either the salvor or the contributing interest.

We quote below extract from the CMI Guidelines:

"The wording of Rule VI paragraph (b) is new to the York Antwerp Rules 2016. It arises from concerns that, if the ship and cargo have already paid salvage separately (for example under Lloyd's Open Form) based on salved values (at termination of the salvors' services), allowing salvage as general average and re-apportioning it over contributory values (at destination) may give rise to additional cost and delays, while making no significant difference to the proportion payable by each party.

A variety of measures to meet these concerns have been considered, ranging from complete exclusion of salvage to using a fixed percentage mechanism. Such measures were found, during extensive CMI discussions to produce inequitable results or were impossible to apply across the range of cases encountered in practice.

It was pointed out that many leading adjusters will, when appropriate, propose to the parties that if re-apportionment of salvage as general average will not produce a meaningful change in the figures or will be disproportionately costly, the salvage should be omitted from the adjustment; it is then up to the parties to decide whether it should be included or not. However, it was considered that a means should be found to make this practice more universal and to set out express criteria that would help to ensure that the allowance and re-apportionment of salvage as general average (where already paid separately by ship and cargo etc.) would only occur in cases where there was a sound equitable or financial basis for doing so.

The average adjusters will still be required to exercise their professional judgment in applying paragraph (b) because several of the criteria (i-v) that are listed require a view to be taken as to what should be deemed to be "significant" in the context of a particular case. Because of the wide range of cases that the York-Antwerp Rules apply to, it was not considered desirable to offer a fixed definition of how "significant" should be construed, other than to note that the objective of the new clause was to reduce the time and cost of the adjustment process where it is possible to do so.

When assessing whether there is a significant difference between settlements and awards for the purposes of Rule VI(b) (v) the adjuster should have regard only to the basic award or settlement against all salved interests before currency adjustment, interest, cost of collecting security and all parties' legal costs."

## RULE XI. WAGES AND MAINTENANCE OF CREW AND OTHER EXPENSES PUTTING INTO AND AT A PORT OF REFUGE, ETC.

New words "entry or detention" are added to paragraph (b)(i) to specify that allowances at a port of refuge are only made possible either when the ship and cargo remain in peril after arrival at the port of refuge or when repairs necessary for the safe prosecution of the voyage are being effected:

(b) (i) When a ship shall have entered or been detained in any port or place in consequence of accident, sacrifice or other extra-ordinary circumstances which render that entry or detention necessary for the common safety, or to enable damage to the ship caused by sacrifice or accident to be repaired, if the repairs were necessary for the safe prosecution of the voyage, the wages and maintenance of the master, officers and crew reasonably incurred during the extra period of detention in such port or place until the ship shall or should have been made ready to proceed upon her voyage, shall be allowed in general average.

The definition of "port charges" is newly added under paragraph (c) (ii) in view of the comments made in the "Trade Green" (2000), which are contrary to the established practice and intentions of successive versions of the York-Antwerp Rules:

 (c) (ii) For the purpose of these Rules, port charges shall include all customary or additional expenses incurred for the common safety or to enable a vessel to enter or remain at a port of refuge or call in the circumstances outlined in Rule XI(b)(i). Also, additional words are added to paragraph (d) (iv) to correct an apparent anomaly:

(d) (iv) necessarily in connection with the *bandling on board*, discharging, storing or reloading of cargo, *fuel or stores* whenever the cost of those operations is allowable as general average.

## RULE XIII. DEDUCTIONS FROM COST OF REPAIRS

Paragraph (c) provides that the costs of cleaning, painting or coating of bottom shall not be allowed in general average unless the bottom has been painted or coated within the 24 months (against 12 months as specified in YAR 1994) preceding the date of the general average act in which case one half of such costs shall be allowed.

## RULE XVI. AMOUNT TO BE ALLOWED FOR CARGO LOST OR DAMAGED BY SACRIFICE

Wording is added in paragraph (a) (i) to deal with issue arising from place of final delivery not being port of discharge, giving express sanction to the long-established adjusting practice:

(a) (i) The amount to be allowed as general average for damage to or loss of cargo sacrificed shall be the loss which has been sustained thereby based on the value at the time of discharge, ascertained from the commercial invoice rendered to the receiver or if there is no such invoice from the shipped value. *Such commercial invoice may be deemed by the average adjuster to reflect the value at the time of discharge irrespective of the place of final delivery under the contract of carriage.* 

## **RULE XVII. CONTRIBUTORY VALUES**

Recognition of the adjusting practice that low value cargo may be excluded from contributing to general average is now expressed in paragraph (a) (ii):

(a) (ii) The value of the cargo shall include the cost of insurance and freight unless and insofar as such freight is at the risk of interests other than the cargo, deducting therefrom any loss or damage suffered by the cargo prior to or at the time of discharge. *Any cargo may be excluded from contributing to general average should the average adjuster consider that the cost of including it in the adjustment would be likely to be disproportionate to its eventual contribution.* 

Furthermore, salvage payment which is not included in general average under the terms of Rule VI (b) would form "an extra charge incurred in respect thereof subsequently to the general average act" and a deduction in order to establish the contributory value of the property. Additional wording in paragraph (b) makes it clear that the deduction in this respect is limited to the actual salvage payment made including interest and costs:

To these values shall be added the (b)amount allowed as general average for property sacrificed, if not already included, deduction being made from the freight and passage money at risk of such charges and crew's wages as would not have been incurred in earning the freight had the ship and cargo been totally lost at the date of the general average act and have not been allowed as general average; deduction being also made from the value of the property of all extra charges incurred in respect thereof subsequently to the general average act, except such charges as are allowed in general average. Where payment for salvage services has not been allowed as general average by reason of paragraph (b) of Rule VI, deductions in respect of payment for salvage services shall be limited to the amount paid to the salvors including interest and salvors' costs.

The insertion of the word "accompanied" in paragraph (e) is to make it clear that unaccompanied personal effects, such as a container full of household goods being moved to another country are liable to contribute to general average: (e) Mails, passengers' luggage and *accompanied* personal effects and accompanied private motor vehicles shall not contribute to general average.

## **RULE XX. PROVISION OF FUNDS**

There is no provision for Commission at 2% to be allowed on general average disbursements.

## RULE XXI. INTEREST ON LOSSES ALLOWED IN GENERAL AVERAGE

Under the YAR 2016, interest will be fixed annually at ICE LIBOR on the first banking day of each year in the currency of the adjustment plus 4%. For interest, it is noted that for a US\$ adjustment that would produce a rate of 5.18% for 2016 as opposed to 7% under YAR 1994.

(a) The rate for calculating interest accruing during each calendar year shall be the 12- month ICE LIBOR for the currency in which the adjustment is prepared, as announced on the first banking day of that calendar year, increased by four percentage points. If the adjustment is prepared in a currency for which no ICE LIBOR is announced, the rate shall be the 12-month US Dollar ICE LIBOR, increased by four percentage points.

## RULE XXII. TREATMENT OF CASH DEPOSITS

A significant change is made to the treatment of cash deposits is noted. Removing the joint account requirement, the new rule sets out more clearly how the average adjuster should handle such funds:

- (a) Where cash deposits have been collected in respect of general average, salvage or special charges, such sums shall be remitted forthwith to the average adjuster who shall deposit the sums into a special account, *earning interest where possible, in the name of the average adjuster.*
- (b) The special account shall be constituted in accordance with the law regarding client or third party funds applicable in the domicile of the average adjuster. The account shall be held separately from the average adjuster's own funds, in trust or in compliance with similar rules of law providing for the administration of the funds of third parties.
- The sums so deposited, together with (c)accrued interest, if any, shall be held as security for payment to the parties entitled thereto, of the general average, salvage or special charges in respect of which the deposits have been collected. Payments on account or refunds of deposits may only be made when such payments are certified in writing by the average adjuster and notified to the depositor requesting their approval. Upon the receipt of the depositor's approval, or in the absence of such approval within a period of 90 days, the average adjuster may deduct the amount of the payment on account or the final contribution from the deposit.

(d) All deposits and payments or refunds shall be without prejudice to the ultimate liability of the parties.

We quote below extract from the CMI Guidelines:

"Under Rule XXII(b) the adjuster is required to hold deposits in a special account constituted in accordance with the law regarding holding client or third party funds that applies in the domicile of the appointed average adjuster. Unless otherwise provided for by the applicable law, CMI recommends that any special account should have the following features:

- Funds should be held separately from the normal operating accounts of the adjuster.
- Funds should be protected in the event of liquidation or the cessation of the average adjuster's business.
- The holding bank should provide regular statements that show all transactions clearly."

## RULE XXIII. TIME BAR FOR CONTRIBUTING TO GENERAL AVERAGE

The YAR 1994 does not include this time bar rule:

- *(a) Subject always to any mandatory rule on time limitation contained in any applicable law:* 
  - (i) Any rights to general average contribution including any rights to claim under general average bonds and guarantees, shall be extinguished unless an action is brought by the party claiming such contribution within a period of one year after the date upon which the general average adjustment is issued. However, in no case shall such an action

be brought after six years from the date of termination of the common maritime adventure.

- *(ii)* These periods may be extended if the parties so agree after the termination of the common maritime adventure.
- (b) This rule shall not apply as between the parties to the general average and their respective insurers.

(Mr. Raymond T C Wong: Average Adjuster)







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