CILTHK

& Ince

Logistics Newsletter

June 2019

# Table of contents

The challenge of smart logistics adoption to SMEs in Hong Kong 03

Update on IMO 2020 07

Legal Update: English Law: When can you set-off claims against freight? 13

Legal Update: Hong Kong Law: Exclusive jurisdiction clauses in bills of lading 16

# The challenge of smart logistics adoption to SMEs in Hong Kong

In previous issues we have looked at Smart Mobility, and ways in which it can assist the logistics industry. This article takes a broader look at smart logistics and potential issues faced by SMEs when deciding whether to implement the latest technologies.

## What are smart logistics?

Smart logistics is the enhancement of the distribution element of the supply chain through advanced and intelligent technology. Not only do smart logistic technologies aim to improve efficiency, but also to reduce the environmental impact of global trade.

Specific to the logistics industry is smart software that will automate many different levels or steps of the chain as well as flag any potential issues from the use of predictive analytics. Smart logistic software utilises real time data streaming from a vast variety of sources thanks to the Internet of Things to give highly accurate and automated processes, such as the initial scheduling and route planning of a consignment, the allocation of available vessels and vehicles, when to dispatch the consignment and under what conditions, and calculating the cost of a particular journey based on these variables and more. Factoring in external influences, such as weather patterns, predictive analytics can say whether a vessel will be delayed in arriving at a port due to a storm at sea.

## Benefits of smart logistic

As with all smart initiatives, the main benefit and driving force is increased efficiency resulting in the provision of a better service and decreased overall costs.

The functionality of smart logistics leads to many benefits regardless the size of the company:

- By using available technology to automate parts of the supply chain it is possible to reduce the number of tasks carried out by people. This can help reduce monthly overheads such as wages which can often be crippling to SMEs.
- Improved operational efficiency as a result of automated sections of the logistics chain which will also lead to reduced overall costs and a reduction in waste.
- Improved communication and flow of goods through the supply chain will provide a more efficient service to end users.
- Improved customer service and experience will effect repeat business, with the aim of increasing it.

## Difficulties facing SMEs

Whilst the benefits of smart logistics in the long run are easy to identify and attractive to all, the initial inception of smart technologies may pose significant difficulties to SMEs.

- Costs – one of the most inhibiting factors will be the cost to adopt the technology. This will undoubtedly require the purchase of software and possibly hardware too (such as sensors for the company's fleet of trucks). It is likely to be a big initial one off payment, however, as with all technology there may be further periodic payments (such as licensing) or ongoing maintenance costs that will need to be factored into the annual budgets.
- IT resources – SMEs, by and large, lack the relevant internal resources to deal with the implementation of smart logistics technology. Generally, SMEs will have small IT departments who skills sets are of a more general office based nature. Cutting edge smart logistic technologies require specialist skills.

- Knowledge and strategy – given the generally small workforce of an SME it is important that everyone is supportive of the strategy of the company going forward including the implementation of modernising technology. There may be a lack of interest in or inability to understanding how smart logistics can benefit the company. If this attitude is driven by more senior employees it will make it harder for the more junior staff to get on board with the new technology.
- Suitability of "off the shelf" software - funding for smart logistics was originally driven by the bigger businesses. The result of this is that smart logistics software is often tailored to operate in a way that is more suitable to a big companies' needs. It is likely that the way smart logistics operate are therefore also tailored to the bigger businesses' needs. How then can an SME get the same level of benefits from the same technologies when their day to day operations are so different?
- Loss of workforce – Whilst the costs of wages for the workforce is arguably one of the biggest overheads for an SME, some fear the big redundancies advanced technology will instigate.
- Access to data – smart technologies, especially in the logistics industry, rely on big data analytics. Access to this information for SMEs may pose several potential issues, such as the cost of obtaining it, should it be bought or should the SME try to collect it themselves? This would require further training and specialist skills again adding to costs. As we explored in a previous issue, there are also many legal requirements and restrictions over the use of big data and personal information. Obtaining legal advice in relation to this may be prohibitive to some SMEs.
- Cooperation from counterparties – the implementation and ongoing effectiveness of smart technologies will rely on the cooperation at all levels of the logistics chain. Considering the relatively small bargaining power an SME will have against a bigger company, it may be difficult to ensure that the smart technology is being used to its full potential if some steps of the chain are using different or incompatible technology. For the end user, the system for booking logistics should be simpler than the method that they are already offered.

Unfortunately, many of the issues faced by SMEs in the implementation of smart logistics cannot be resolved without additional external help.

## Hong Kong's drive for SMEs

At the end of 2018 there were a total of 338,113 SMEs in Hong Kong employing approximately 1.3 million people. Roughly 110,000 of these SMEs were in the Import/Export trade industry whilst another 8,500 SMEs were in the transportation, storage, postal and courier services category. Clearly a lot of businesses would benefit from the implementation of smart logistics.

In its 2017 Policy Address, the Hong Kong Government announced that it would make a HKD 1.8 billion investment into Hong Kong's innovation and technology ecosystem, which was to include research projects, subsidizing industry adoption of technology to upgrade and transform, and supporting start-ups.

There are several grants and awards offered by different Hong Kong bodies that are aimed at SMEs, ensuring that they are not left behind when it comes to implementing smart technology. Amongst these are:

- The Office of the Government Chief Information Officer (OGCIO) set up the Hong Kong ICT Awards in 2006 with the aim of promoting inventions and applications of ICT (information and communications technology). The 2018 Smart Mobility Award in the sub category of Smart Logistics went to BPS Global Holdings Ltd for their Hong Kong Smart Automated Warehouse Solution. With the judges commenting that the solution maximised operational efficiency whilst overcoming challenging integration with the variety of warehouse equipment.
- The Trade and Industry Department offers the SME Loan Guarantee Scheme, whereby it will act as a guarantor so that an SME can obtain a loan from one of the participating lending institutions. The loans are for specific functions including *"acquiring business installations and equipment".*
- The Trade and Industrial Organisation Support Fund (also run by the Trade and Industrial Department) provides financial support for SMEs to implement projects that encourage competition in the same sector.
- The Innovation and Technology Bureau launched the Technology Voucher Programme in 2016 with the aim of subsidising local SMEs in using technological services and solutions to improve productivity.

So while there are several hurdles for SMEs to overcome in the implementation of smart logistics, it is encouraging to see that the Hong Kong Government is trying to support the changes.

Nicola Tune
Registered Foreign Lawyer
(England & Wales), Hong Kong
T +852 2877 3221
nicolatune@incegd.com

# Update on IMO 2020

Ships typically burn heavy fuel oil ("**HFO**") in their engines. This produces emissions containing carbon dioxide, nitrogen oxide, sulphur dioxide and particulate matter which contribute to air pollution. Whilst limits on the maximum sulphur dioxide content of vessels' emissions have been in place for some time, both globally and locally, on 1 January 2020 the global maximum threshold is going to reduce significantly as a result of IMO regulations. This article will look at what those regulations require and the impact they will have on the shipping supply chain.

## MARPOL Annex VI, regulation 14

The key IMO instrument governing sulphur dioxide emissions from vessels is MARPOL Annex VI, Regulation 14 (the "Regulation"). It provides that as of 1 January 2020, all vessels (registered with flag states that have ratified Annex VI or vessels passing through or calling at port states which have ratified Annex VI) will be subject to the following requirements:

- The limit for the sulphur content of fuel used on board a vessel operating outside one of the four Emission Control Areas ("ECAs") decreases from 3.5% mm to 0.5% mm. Within the ECAs the limit remains 0.1%.
- Compliance with other operational requirements such as:
  - Vessels must produce a bunker delivery note stating the sulphur content of any fuel oil stemmed;
  - Vessels must carry an International Air Pollution Prevention (IAPP) certificate;
  - Vessels must have onboard a written procedure for fuel oil changeover when entering/leaving an ECA; and
  - Vessels must maintain a log (as prescribed by their flag state) recording adherence to the changeover procedure.

In addition, from 1 March 2020 vessels will be prohibited from carrying non-compliant fuel unless they have scrubbers fitted.

Source: Louise Hall, (2015), *MISC-Map-for-blog* [ONLINE]. Available at: https://www.shipownersclub.com/louise-hall-sulphur-requirements-imo-emission-control-areas/.

## Implementation

The Regulation is fairly simple, requiring compliant fuel to be burned and appropriate records kept. However, the difficulty with the Regulation, and what is subject to a significant amount of debate at the moment, is its practical implementation. The debate is caused by the fact that shipowners have a choice as to how they comply with the Regulation, as long as the methods they choose are as at least effective at reducing emissions as that required by Annex VI. This has meant that a number of solutions are currently being implemented, with different solutions being adopted by different owners and even different solutions being adopted for different ships in the same fleet of ownership.

The three main methods of compliance and their advantages / disadvantages are summarised below and overleaf:

| Method of compliance | Advantages | Disadvantages |
|---|---|---|
| **Low sulphur fuels** | – The most obvious solution, and the one which ships and crew are most familiar because low sulphur fuel oil has been the fuel used in ECAs for some time.<br><br>– Low sulphur fuel oil can either be HFO that has been de-sulphurised, or distillate fuels such as Marine Gas Oil (MGO). | – Uncertainty regarding the availability of LSFO / MGO in the volumes required come 1 Jan 2020. The switch from HFO to LSFO / MGO by what is expected to be the vast majority (circa 90-95%) of the world's fleet also requires a shift in production in refineries, with some estimating a production shift of up to 4 million barrels per day being required. Future supply volumes remain uncertain, despite announcements by oil majors such as Exxon seeking to reassure customers that they will have sufficient stocks, and with some of the large lines announcing that they have already secured supplies.<br><br>– Concerns over quality, safety and compatibility as refiners seek to create new, untested blends of fuels which meet the new emissions standards. There is as yet no international standardization governing blended fuels, raising concerns about increased dangers to crew and vessel damage.<br><br>– Concern regarding the effect of LSFO / MGO on engines designed to run on thick, viscous HFO. LSFO / MGO has a much lower viscosity and can cause operational issues if appropriate advice is not taken from engine manufacturers. |

| Method of compliance | Advantages | Disadvantages |
| --- | --- | --- |
| **Alternative fuels (Gas / Methanol)** | – When ignited, gas leads to negligible sulphur oxide emissions.<br>– Tested engine technology as LNG carriers have been doing this for many years. | – Limited bunkering infrastructure, although LNG bunkering is growing. |
| **Exhaust gas cleaning systems** | – Exhaust gas cleaning systems or "scrubbers", "clean" the emissions before they are released into the atmosphere. If scrubbers are installed, the vessel can continue to use HFO. | – The time and cost of installation and maintenance. Retrofitting a scrubber system is no small task – it takes around 6 weeks and at least a few million dollars. Recent estimates are that around 10% of the world's container ship fleet will be fitted with scrubbers come 1 Jan 2020 although that is likely to increase as newbuilds are delivered.<br>– Recently, some jurisdictions have banned the discharge of wash water from "open loop scrubbers" including, China and Singapore, raising operational questions.<br>– The need to retain some stores of LSFO / MGO onboard for operations in ECAs or in the event the scrubber breaks down.<br>– Uncertainty regarding ongoing supply and price of HFO, as refineries switch production to meet the increased demand for LSFO / MGO. |

## Sanctions for non-compliance

The IMO's position is that come 1 Jan 2020, all vessels must comply and there will be no grace period for the transition. The IMO itself however has not set out what the sanctions for non-compliance are to be, but this is left to each individual state member to determine.

By way of example, in Hong Kong, the master and owner concerned of any vessel using non-compliant fuel within the waters of Hong Kong will be liable to a maximum fine of $200,000 and imprisonment for six months. Shipmasters and ship owners of ocean going vessels who fail to record or keep the required particulars will also be liable to a maximum fine of $50,000 and imprisonment for three months.

## Impact on Shippers

As is the norm with IMO regulations, the obligations are imposed predominantly on shipowners, with additional obligations on contracting states (e.g. promotion of availability of compliant fuels, maintaining a register of local fuel oil suppliers and requiring them to provide the bunker delivery note and sample as required by the Regulation).

Nevertheless, the Regulation is relevant to all users of shipping services because it is likely to have a negative impact on shipping services, at least in the short term. Some anticipated impacts of the Regulation include:

- Possible vessel detentions for non-compliance.
- Delay for a multitude of reasons - non-compliance, to remove non-compliant bunkers, as a result of engine failures, lack of available fuel, fuel incompatibility, deviation for compliant bunkers, slow steaming.
- A change in trade routes, with shorter sea routes favoured and slow steaming leading to possible increases in transhipment.
- A possible surge in freight demand immediately prior to the implementation of the regulations in 1 Jan 2020.
- Increased costs.

LSFO and MGO already trade at a premium to HFO. Following the switch to LSFO / MGO by the majority of the world's fleet on 1 January 2020, demand is expected to outstrip supply pushing up LSFO / MGO prices even further. In addition, shipowners who choose to install scrubbers have additional capital expenditures that they will be looking to recoup. Shipowners / operators will be seeking to pass these costs down to shippers either through result of surcharges or bunker adjustment factors, and some lines have already implemented this.

In addition, the extra demand for MGO or LSFO blends which use distillates, is also expected to have an effect on other transport modes such as air and road transport. These modes already use distillate fuels, so as the demand for distillates rises due to the increase in marine demand, it is expected that airlines and road haulage companies will also see increased fuel costs which they too will be seeking to pass on to customers. It is however expected that supply and costs issues will ease in the medium term as new supplies of LSFO / MGO come on line.

## What can I do to prepare?

Although the Regulations do not come into force for a further seven months, shippers should be preparing for the impact of their implementation now. Some practical steps you can take to seek to mitigate the impact of the Regulation include:

- Understanding how your key carrier partners are choosing to comply with the Regulation;

- Reviewing your service agreements / rate agreements with carriers, to ensure they contain adequate clarity and transparency on bunker adjustment factors calculations, including what indexes are being used, the application of the BAF and terms regarding its modification;
- Pushing for transparency from carriers on all additional surcharges related to IMO 2020 compliance;
- Optimising freight across modes, to account for potential delays in ocean carriage in the later part of 2019 / Q1 and Q2 2020;
- Securing ocean carriage space now to avoid the expected surge in demand in late 2019.

This is a fast-developing area and as the implementation date approaches, we expect to see further developments in how the Regulation will impact not only the shipping industry but its customers too. If you have already been affected or consider you will likely be affected by the Regulations and wish to discuss this further, please do get in touch.

Joanne Waters
Senior Registered Foreign Lawyer (England & Wales), Hong Kong
T +852 2877 3221
joannewaters@incegd.com

# Legal Update: English Law: When can you set-off claims against freight?

The Commercial Court has confirmed that the rule in The "*Aries*", which precludes set-off against freight, does not extend to sums payable to a freight forwarding agent for arranging carriage under a freight forwarding contract.

## The background facts

In 2014 the Chinese energy giant Sinopec was engaged for the modernisation of the oil refinery at Atyrau in Kazakhstan, near where the Ural river drains into the Caspian Sea. Sinopec engaged DHL to arrange the transport of refinery units from China.

DHL sub-contracted Globalink for the sea and road leg from the Black Sea port of Novorossiyk through the Ural-Caspian canal to the refinery. Their agreement was entitled "*Freight-Forwarding Services Contract*", Globalink was referred to as the "*Forwarding Agent*", and they were to be liable for any delay in delivery.

In October 2014 two barges carrying the units launched from Novorossiysk. One barge failed to arrive at the destination because the water level in the Ural-Caspian canal was too low for its draught. To make matters worse, on 23 November 2014, the Ural-Caspian canal closed for winter, so some of the cargo had to be put into storage. Globalink were only able to complete the carriage to the destination when the canal re-opened the following spring.

As a result of this delay, DHL refused to pay the final two instalments of the contract price due to Globalink. Globalink brought a claim for those sums plus the winter storage charges, amounting to USD 1,647,780. DHL contended that they had a counterclaim of USD 2,364,976.05, being the costs they incurred in excess of what they would have paid to Globalink if the original agreement been fulfilled.

Globalink applied for summary judgment, relying *inter alia* on the rule precluding the set-off of counterclaims against the payment of freight under voyage charterparties.

## The legal issues

Defendants to claims for money due under commercial contracts often resist payment on the basis that they have a counterclaim, which they wish to set-off against the sums due. English law generally permits this where a claim and cross-claim are so closely connected that it would be unjust to enforce one without taking the other into account.

One notable exception is the long-established principle that a defendant is not entitled to raise any counterclaims it may have in order to reduce the freight payable under a contract of carriage.

The Courts have taken a strict approach in only applying this rule to claims for freight payable under a contract of carriage. It does not, for example, extend to claims for hire under a time charterparty. However, while the rule is most widely known for its application to freight payable under voyage charterparties, it is not limited to the carriage of goods by sea and has been held to apply to the carriage of goods by road and by air.

It has also been held, in *Britannia Distribution v Factor Pace* [1998] 2 Lloyds Rep 420, that if a freight forwarder has acted as agent in entering a contract of carriage with a carrier and that carrier charges freight, then the forwarder is entitled to claim the sums due for that freight from his principal and the rule against set-off applies.

In this case, Globalink argued that the sum charged by Globalink to DHL was charged in consideration for transporting the equipment from one place to another. It is therefore properly described as freight, such that the rule in *The Aries* should apply.

DHL argued that the rule in *The Aries* only applies to contracts of carriage and that this was not such a contract. It was instead a contract to arrange carriage and was not subject to the rule against set-off.

## The Commercial Court's decision

The Judge's starting point was to consider the nature of the contract between the parties. He noted that the contract described itself as a freight forwarding agreement, not a contract of carriage.

He stated that "*the essential nature of* [Globalink's] *obligation is not an obligation to carry, but an obligation to procure that carriage is achieved by others.*" The fact that Globalink could incur liability for delayed delivery of the cargo did not mean that Globalink was a carrier, nor that Globalink accepted an obligation to deliver on a particular date, it just meant that if Globalink did not arrange for others to deliver the cargo by that date it would incur a penalty to DHL.

The Judge considered that applying the no set-off rule in this case would represent an extension of the existing law, extending the ambit of the rule beyond contracts of carriage and beyond freight in the narrow sense established by the authorities.

He concluded that it was not open to him to extend the rule to cover the services provided by a freight forwarding agent, when those services are simply to *arrange* the carriage of goods.

## Comment

This decision confirms that the rule preventing set-off against freight only applies in cases of payment of freight under a contract of carriage. It will not assist freight forwarders who merely contract to arrange the carriage of goods by another.

It is advisable for freight forwarders who wish to avoid deductions being made from payment due to them to insert clear wording in their contracts, requiring the payment of all sums due in full and prohibiting their counterparty from making any deductions or set-offs against the sums that are payable.

Carl Walker
Partner, London
T. +44 (0) 20 7481 0010
carlwalker@incegd.com

Iain Preston
Claims Executive, Hamburg
T. +494038086187
iainpreston@incegd.com

# Legal Update: Hong Kong Law: Exclusive jurisdiction clauses in bills of lading

## *Li Lian International Ltd v Herport Hong Kong Ltd [2019] HKCFI 826* / [2019] HKEC 964.

### Background

These proceedings arose from the well-known events resulting in the loss of the container vessel *MOL Comfort* (the "Vessel").

Various cargo interests whose cargo was lost in the incident sought to bring claims in Hong Kong. They brought those claims against Herport, who had acted as a Non Vessel Owning Common Carrier ("NVOCC"). That was in line with the provisions of the bills of lading that Herport had issued (the "Herport B/Ls").

Herport then sought to join NYK, to whom they had subcontracted the carriage of the cargo in question, to the Hong Kong proceedings. NYK resisted, on the basis that the terms of the bills of lading they had issued (the "NYK B/Ls") gave the Tokyo Court exclusive jurisdiction. Clause 3 of the NYK B/Ls provided as follows:-

> "3. (Governing Law and Jurisdiction) (a) The contract evidenced by or contained in this Bill of Lading shall be governed and construed by Japanese law except as may be provided for herein, and (b) notwithstanding anything else contained in this Bill of Lading or in any other contract, any and all actions against the Carrier in respect of the Goods or arising out of the Carriage shall be brought before the Tokyo District Court in Japan to the exclusion of the jurisdiction of any other courts whilst any such actions against the Merchant may be brought before the said Court or any other competent court at the Carrier's option ..."

Herport obtained leave on an *ex parte* basis to join NYK and to serve them in respect of the Hong Kong proceedings. NYK challenged that decision.

The issue before the court was whether the exclusive jurisdiction clause contained in the NYK B/Ls was sufficient for NYK to resist being joined to the Hong Kong proceedings.

### The Court of First Instance decision

The Court of First Instance (the "Court") gave effect to the exclusive jurisdiction clause in the NYK B/Ls and held that the previous order for leave to join and serve NYK should be discharged and set aside.

The practical impact of the decision is that Herport are left facing a raft of claims in Hong Kong which they will not be able to pass on to NYK. They are precluded by this decision from suing NYK in Hong Kong and, having not previously sought to bring proceedings in the Tokyo Court, appear now to be time-barred from doing so.

The decision is in-line with the practice of the Hong Kong Court, which is to give exclusive jurisdiction clauses made between the parties a "generous" interpretation, in favour of the party seeking enforcement of the clause. The Court will generally give effect to such a clause, unless there are strong reasons for departing from it.

Notwithstanding this general approach, the Court will take a more restrictive approach where there is ambiguity in the clause in question. In this case, however, the Court saw no ambiguity. The phrase "*any and all actions against the Carrier*", as analysed in the judgment, "*means just that*".

Herport further sought to argue that this was a case in which there were "*strong reasons*" to depart from the exclusive jurisdiction clause. Such "*strong* reasons" will generally have to be factors not the in reasonable contemplation of the parties at the time when the agreement was made.

Herport's argument was that it would benefit from a "*juridical advantage*" if it was able to continue with the claim against NYK in Hong Kong, given that the time limit to bring the same claim in Japan had expired. The Court dismissed this argument, saying that the alleged "*prejudice*" Herport would suffer was an "*entirely foreseeable situation of its own making*". On that basis, the Court concluded there were no "*strong reasons*" to depart from the exclusive jurisdiction clause.

## Comment

The decision illustrates one of the potential risks associated with acting as an NVOCC. An NVOCC assumes potential liability for damage and/or losses of the cargo, notwithstanding that they are not the actual carrier and have sub-contracted the carriage to someone else. It follows that it is essential for an NVOCC to be sure that they can pass any incoming claim from cargo interests on to the actual carrier (or another party). Here, the differing law & jurisdiction provisions in the two sets of B/Ls left Herport in an unfortunate situation, which was then compounded by not bringing a claim before the Tokyo Court.

Bills of lading are, of course, usually standard form documents, with limited scope for amendment. Certainly it is difficult to see in this case that Herport would have had much scope for amending the terms of the NYK B/Ls, even had they perceived the potential issue. Herport were, however, in control of the terms of their own B/Ls.

It would have been possible, for example, to have included a clause which would have compelled cargo interests to bring any claims in the same jurisdiction where Herport would have to sue the party to whom they had sub-contracted the carriage. Such a clause is not straightforward (and it would have left Herport involved in two sets of proceedings in an unfamiliar jurisdiction), but it would have prevented the situation Herport ultimately found itself in, where it was in the middle of a chain, but on terms which were far from back-to-back.

Finally, it is unclear from the judgment whether Article III, rule 6*bis* of the Hague-Visby Rules might assist Herport with the time limit issue. Certainly Herport's case seemed to accept that they would be time barred from bringing any kind of indemnity claim in Japan. Ultimately, this is a matter of Japanese law and no doubt an issue Herport have examined closely.

Ruaridh Guy
Senior Registered Foreign Lawyer (England & Wales), Hong Kong
T. +852 2877 3221
ruaridhguy@incegd.com

Suki Fung
Trainee Solicitor, Hong Kong
T. +852 2877 3221
sukifung@incegd.com

# Contact Ince logistics insights

**David Beaves**
Managing Partner, Hong Kong
DavidBeaves@incegd.com

**Rosita Lau**
Partner And Lead Partner Of The Ports
And Terminals Practice, Hong Kong
And Greater China
RositaLau@incegd.com

**Joanne Waters**
Senior Registered Foreign Lawyer, Hong Kong
JoanneWaters@incegd.com

Ince & Co is a firm of solicitors regulated by the Law Society of Hong Kong.

E: firstnamelastname@incegd.com / incegd.com

24 Hour International Emergency Response Tel: + 44 (0)20 7283 6999
LEGAL ADVICE TO BUSINESSES GLOBALLY FOR OVER 140 YEARS.
©Ince

IMPORTANT NOTICE: The contents of this document and any attachments are strictly confidential to the intended recipient(s) and may be privileged. If you are not the intended recipient(s) please do not use or publish its contents and notify us as soon as possible. If received by email, please also delete the message from your system and destroy any copies.