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Shipbroking and Chartering Practice 7th Edition

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SHIPBROKING AND CHARTERING PRACTICE

By

LARS GORTON

*Professor of Banking Law at the University of Lund
Professor Adjunct of International Business Law,
Stockholm School of Economics*

PATRICK HILLENIOUS

Shipbroker

ROLF IHRE

Advocate

ARNE SANDEVÄRN

Shipping Consultant

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PREFACE

This book was originally based upon a project launched by the Swedish Ship-owners' Association in conjunction with Liber Hermods, a Swedish publisher. The volume (entitled *Befraktning* in Swedish) was intended as a basic textbook for persons working in shipping: brokers, exporters, agents, shipowners, sea and land personnel. The first edition of the English version was rather different from the basic Swedish book, and the present edition is quite different from the first English version.

Several adjustments have been made to this seventh edition to adapt the text to the occurrences of the previous few years and to mirror the late events within the shipping sector. We have received some letters giving us new ideas, and we have again had the opportunity to discuss with several people different problems which have arisen. We thank all those who have shared with us their experience in the field and would appreciate it if readers could continue to do so as well as let us know if there are parts that are superfluous, incorrect, too superficial, etc. Please send all such information to Informa Law, or directly to the authors at the following address: Lars Gorton, Stockholm Center of Commercial Law, University, 10691 Stockholm, Sweden or email Lars.Gorton@juridicum.su.se.

It should be emphasized that this book is a basic textbook containing no sophisticated legal information on interpretation of clauses; the reader who needs precise information on specific points should refer to specialized literature. Since the third edition we have introduced some short case notes that are intended to illustrate certain principles. Our cases have been mainly selected from English and American case law. The intention is that the reader is given a general idea of what chartering is about from a practical economic-administrative and, to some extent, legal point of view. On the subjects of the sale and purchase of ships and ships' financing there are excellent modern textbooks available, so we have restricted ourselves here to examine only some practical day-to-day matters, and especially those relating to chartering work. If more illustrative cases are required in a future edition we shall gladly introduce them. Similarly, if there are topics which need more elaboration, we shall do our best to achieve that.

*Lars Gorton, Patrick Hillenius, Rolf Ihre, Arne Sandevärn
April 2009*



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INTRODUCTION

The maritime industry has undergone gradual structural changes with respect to the legal surrounding, safety mechanisms and the organization of the shipping company. The earlier shipping company was often not very large and was frequently involved in all operations relating to a vessel: ownership, manning, technical operation and commercial operation. Before the introduction of containers during the 1960s and the arrival of intermodal carriage, the activities of the shipping company were quite different from today. Several factors have contributed to these changes.

One is the separation of the various functions of a shipping company into: the *owning* function (including financing); the *management* function (manning, technical supervision, spares, bunkers, etc.); and, sometimes, the *operational* function (daily routines concerning the vessel); and the *commercial* function (mainly the trading of the vessel). These functions are often divided between different companies, frequently in different countries, and there may be a set up of different agreements/documents relating to the different functions, such as management agreements, operation agreements and chartering agreements.

An international shipping group may be set up in a variety of ways, and the shipowning company is often situated in a country with an open registry, sometimes referred to as a “flag of convenience country”. Apart from the shipowning company(ies), the shipping group may consist of several other companies in different countries handling the various functions. It is likely that the fleet will be owned through single-vessel companies. The increasing costs have resulted in larger, and often more specialized, entities, such as large container operators, car carrying companies, bulk ship operators, oil carrying operators etc.

Shipowners may co-operate through different types of joint ventures sometimes referred to as *shipping pools*. In this way, resources such as manning, technical development or marketing can be pooled. Further savings may be made if the activities are channelled through a jointly owned company situated in a tax haven. During the last hundred years, a particular type of cartel has developed in liner shipping, known as *liner conferences*. Liner conferences have been the subject of anti-trust law discussions and both the US and the EU have legislation prohibiting certain types of co-operation agreements. To a large extent, shipping activities are also embraced by such rules. We also see an ongoing development worldwide,

where companies enter into an even closer co-operation by forming a *consortium*, which for all practical purposes will market itself and perform services as one international company. This may happen within the framework of a pool or a liner conference, but there have been cases where the new mega-company has left the conference and continued in the same trade as an outsider. Within the EU, the competition rules have also become applicable to shipping generally, resulting in shipowners checking closely on the requirements set up according to competition law. Furthermore, there has been growing competition between large freight forwarders and liner shipping companies. Shipbrokers are also getting more international.

The activities of a shipping company normally start with a shipbuilding contract (or memorandum of agreement (MoA) for the purchase of a second-hand vessel). The documentation for the financing of a ship is routinely extensive and comprises various documents, particularly in respect of financial security, such as the ship mortgage. Upon delivery of the vessel a bill of sale will be handed over from the seller to the buyer. The management function is documented in a *management agreement* between the owner and the manager, spelling out the manager's duties. A particular operations agreement may be concluded between the owner and the operator. Commercial activities may be carried out by a broker, normally working in close co-operation with the owner but on an *ad hoc* basis and without particular authority to bind the owner. Sometimes a particular chartering agreement may give a particular organization authority to employ the vessel for the owner and the chartering will then be performed by this organization for the owner.

Shipping is an international business and people involved in chartering work have to deal with the conditions prevailing day-to-day in the international freight market. A large number of customs and rules of the trade have been established through the years and strict business ethics have developed that should be observed in the professional shipping business.

Chartering work is essentially a form of information exchange. It is one of those trades where, in order to be successful, it is essential to have the right information at the right time. Everyone involved in chartering acts is, to a large extent, a collector, judge and distributor of information. A great deal of the flow of information consists of, for example, notes on fixtures all over the world. "Making a fixture" means that the parties interested in a specific sea transport, through negotiations, reach a mutual agreement on all details in a charter.

The parties involved in a charter deal are, on the one hand, someone who owns or operates a ship (owner, time-chartered owner or disponent owner), and, on the other hand, someone who requires a sea transport to be carried out (normally, but not always, the cargo owner—in a charterparty the counterpart of the shipowner is called the charterer). The parties normally negotiate through the intermediary of representatives called shipbrokers or booking agents. The owner of the cargo (often the shipper or the consignee) is often also the charterer.

The document drawn up after conclusion of the negotiations is called a charter-

party, or if booking of general cargoes is concerned, a booking note. In most cases the brokers representing the charterers draw up the original documents, which are often signed by the respective brokers on behalf of the parties (sometimes only with the name of the brokers “as agents only”). Subsequently, upon the receipt of goods or their loading onto the vessel, a *bill of lading* is normally issued by or on behalf of the carrier.

Chartering negotiations are carried out day and night and nearly always under time pressure. It usually takes no more than a day from the time a shipping order has been placed on the market until a fixture has been confirmed. The negotiations are normally conducted over telephone, telex and telefax, but to a growing extent email and internet functions are being used.

In practice and by law, all agreements, whether given in writing or by word of mouth, are, with certain exceptions, of equal value. As early as the beginning of the century the expression “our word is our bond” was coined among those dealing with professional chartering in London. For the sake of evidence, however, it goes without saying that it is appropriate to have the agreements drawn up in writing.

There has been a steady development of new standard form charterparties as well as revisions of older forms. We have, for illustration, chosen some of those that seem to have considerable spread, particularly in certain shipping areas.

Anybody involved in shipping will have to be aware of rules and regulations related to safety questions. Environmental questions are increasingly important. The impact of piracy in certain parts of the world also has to be taken into consideration. The ports have often moved from central parts of cities developed as commercial centres to the outskirts of these places.

So, it is clear, all in all, the shipping and the transportation sectors have been undergoing structural changes during several decades.



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Hansa International Maritime Journal

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Lloyd's Law Reports

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Lloyd's Maritime Law Newsletter

Seatrade (monthly)

The Journal of Business Law

Tradewinds

Market reports and statistics supplied by international shipbroking firms, such as I.A. Clarkson, Fearnleys, Galbraiths, Simpson Spence & Young.

CHAPTER 1

THE FREIGHT MARKET

The freight market is not a uniform market where the trend is entirely up or down. Instead, it consists of a number of different part-markets, which are not necessarily dependent on one another and can often develop very differently. The freight market does not have a homogeneous connection with a specific geographical area but rather with ships that can carry similar types of cargo.

The current trend or state of the market is determined by the balance between the supply and demand of shipping services of various kinds. A measure of the state of the market is the freight level which a certain type of vessel can obtain in various standard trades. The freight market is, of course, dependent on the state of the world trade market and the ever-changing price of oil. The price of oil affects both world trade and owners' costs for bunkers, but it is also sometimes strongly influenced by circumstances such as war, widespread strikes, bad harvests, ice-bound waters, etc. Another important factor which affects the freight market is the granting of government subsidies to shipyards. It goes without saying that there is an interrelation between the new-build market, the second-hand tonnage market and the freight level, although these are not synchronized in detail. This also means that, like new-building, scrapping also affects the freight market.

Contact between the different freight markets may be more or less extensive. This depends on the type and size of ships, the commodities involved and, to a certain extent, on the distance of transportation. Each freight market has, however, different interested parties and thus often has separate networks of information and information channels.

The world fleet of merchant ships above 300 gross tonnage consists of some 70,000 vessels, with a total tonnage of about 1.22 billion tons deadweight (d.w.). About 9 per cent of this total tonnage consists of ships of under 10,000 tons d.w. Tankers represent only about 12,700 units, but account for 37.5 per cent of the total tonnage. Disregarding some 8,000 vessels employed in other markets, the number of ocean-going ships in the typical dry cargo market is still large—roughly 22,000 units.

A basic division into principal freight markets can be made as follows:

- the dry cargo market;
- the tanker market;

- the reefer market;
- the car carrier market; and
- the passenger market.

THE DRY CARGO MARKET

With respect to types of trade as well as types of ship the dry cargo market is the most diversified. Some parts of this market may at times show a market picture which is quite different from the dry cargo market in general.

What are common to the various sectors are information centres and information channels. To be able to consider alternative employment for the ships, to judge new-building requirements, to develop new types of vessel, to attempt solutions to transportation problems and to seek new trading opportunities, dry cargo owners must follow what is happening within the dry cargo market as a whole, as well as what happens from day to day in important shipping centres like London, Oslo, New York, Tokyo and Hamburg. This is done through specialized shipbrokers as well as through direct contacts between owners and charterers. The charterers also have to follow what is taking place within the whole dry cargo market to be able to obtain optimum solutions to their transportation needs

The dry cargo market may be subdivided into the following sectors:

- bulker;
- 'tweendecker;
- container;
- ro/ro;
- liner;
- small ships; and
- special.

The bulk and 'tweendecker market

The vessels operating in this market vary greatly in size—from about 5,000 tons d.w. up to 180,000 tons and more. Although a division into size-class cannot be very distinct, there are certain differences which are recognized in day-to-day market discussions. A standard type 'tweendecker now generally means a vessel of 17,000–23,000 tons with her own gear of derricks and/or cranes and with one 'tweendeck throughout. Sophisticated general cargo vessels are mostly built with a certain type of trading in mind, for example, forest products, within the capacity brackets of about 6,000–20,000 tons d.w. In bulk carriers there is an important number of smaller types, 5,000–10,000 tons d.w. engaged in free trade, quite often on a worldwide basis. These ships have their own gear, such as the big and very important group of bulk carriers within the 25,000–35,000 tons bracket, which are referred to as “handysize bulkers”.

During the 1990s the class of bulk carriers within the 35,000–45,000 d.w. bracket, that can best be described as enlarged handysize vessels and referred to as “handymax”, has become well established and is continually increasing in number. The ships are mostly built with good gear and are not necessarily in competition with the original handysize market.

The Supramaxes, that is, bulkers ranging from 45,000–55,000 d.w., often equipped with their own grabs, were introduced at the end of the 1990s and have now formed a niche of their own.

In the next big group of bulkers, taking a step up in size, we find the so-called “Panamax bulkers”, which means vessels representing the largest measurements allowed in length, beam and draught for passage through the Panama Canal in loaded condition. The deadweight range is about 55,000–80,000 tons with a concentration within the 68,000–73,000 tons bracket. These ships are mostly gearless and are busy in the main grain, coal and ore trades.

During recent years we have seen an increased number of ships in excess of 80,000 d.w. being referred to as Kamsarmaxes, which can still make it through the Canal, and post-Panamaxes that are unable to proceed via the Canal with its present restrictions.

The important size-class of bigger ore and coal carriers, from 90,000 tons and upwards (with a diminishing number in the smaller sizes), are frequently referred to as “Cape-size” vessels. In the daily communication brokers sometimes use a subdivision of this class, like “small cape” for the capacity up to 150,000 tons d.w. A “normal” Cape of today would be a ship of 160,000–180,000 d.w. and a “large Cape” over 180,000 tons d.w., reserving VLO or VLOO for sizes above 200,000 tons.

Within the bulk sector one has to follow the variations in supply of the important bulk cargoes such as coal, grain, ores and concentrates, scrap, steel, cement, phosphates and fertilizers.

Owners of specially equipped vessels also have to keep in touch with the market for the shipments of, for example, lumber, woodchips and cars. Modern bulk carriers can also be used for the transportation of unitized cargoes of various kinds, like paper and pulp, and also for containers, etc. All ships able to carry these commodities are competitors within the same market sector. This means that when making voyage calculations it is necessary to calculate on all the various cargo combinations or chartering alternatives and set the freight or daily hire at a level with the current market conditions within the entire market sector in question.

Ships fitted with specialized equipment or designed for a particular area have to look to their own specific section of the market in order to charge the extra rate on top of the current freight rate, which is required to pay off investments in equipment and construction. Examples of these are vessels equipped with their own grabs for discharge of bulk commodities (“self-dischargers”), vessels specially constructed with the measurements and fittings required for passage through the St Lawrence Seaway during the season (“Lakes traders” or “Lakes-fitted vessels”) and vessels

built to “ice-class”, which are suitable for trading into the Baltic or to Canada during winter conditions.

Even the standard type ’tweendeckers carry bulk cargoes, but the number of such vessels in the bulker trade is falling continuously in favour of genuine bulk carriers. The most important employment possibilities for ’tweendeckers are, on the one hand, shipments of all kinds of bagged commodities, for example, sugar, rice, cement and fertilizers, and, on the other hand, employments as supplementary or “extra” vessels for the regular lines.

Most liner trades are now fully containerized. Cargoes not suitable for containerization or otherwise left over by the regular lines, as well as the lines’ continued requirement of “extra” ships for trip or short period, have become an interesting market for the modern handysize bulkers often referred to as “multi-purpose” vessels, and for the standardized types of modern ’tweens in the 17,000–25,000 tons sizes.

The market variations for bulkers and ’tweendeckers follow each other to a great extent. Both groups of ships also normally use the same brokers, although the individual shipbroker is often a specialist within a sector.

The container market

In the early era of containerization it was thought that containerships of the lift on/lift off type (lo/lo) would totally knock out the conventional liners from the important trades. This did not occur and, instead, there developed pure container trades parallel to conventional liner traffic, or rather to a traffic of semi-liner character employing modern standard-type ’tweendeckers as well as handysize bulkers.

The container ship has long established its place, especially in traffic plying between highly industrialized areas with a technically advanced inland transportation system in both the exporting and the importing areas. This traffic requires large investment in specially equipped vessels, port installations and terminal equipment. Container ships are often operated by international joint venture organizations, consortia and pools, partly because of the high investment costs involved and also for multinational marketing purposes and to meet the bigger customers’ demand for total undertaking and value-added services. To a growing extent, container vessels with refrigerated containers are taking over some of the reefer market.

The time charter market (T/C) for container ships has proved to be the market sector which is often the first to react to a change in the state of the world trade market and this is probably so because these ships are employed in the worldwide movement of finished high-technology products. The container ships are subject to competition from modern ’tweendeckers of standard type as those vessels, to some extent, can also carry containers. Competition is also felt from bulk carriers constructed to be suitable for container handling.

The market for container ships is limited and there is only a small number of brokers who are specialized in the chartering of such vessels. The sizes of the larger

container vessels are continually increasing (now up to the so-called “post-Panamaxes”), and the total number of ships in the world container fleet is increasing quite rapidly.

During the last couple of years we have seen freight rates for dry cargo increase rapidly, making charterers look at alternative shipping solutions. Thus, some trades that used to be reserved for the bulk carriers are now fully containerized. This applies not only to unitized cargoes like wood pulp or lumber, but also to pure bulk cargoes such as chrome ore or other minerals.

The ro/ro market

The ro/ro market as a sector of its own was established rather late, about three decades ago. Initially these ships were typical short-trade carriers in trades between highly industrialized countries. Several circumstances have, however, caused these vessels to participate as a natural part of ocean traffic.

During the 1970s the movement overseas of industrial products, machinery, vehicles and building materials increased considerably, especially from Europe and the United States to the Middle East, as well as to West Africa from Europe. The ports in the importing countries had a low capacity at the time and, therefore, ran into serious congestion caused by too many vessel arrivals and the inability to cope with the increasing quantity of cargo. At the same time, the liner companies trading to these areas with conventional general cargo ships began to renew their fleets.

One solution to these problems was the ocean-going ro/ro ship, requiring a minimum of port installations, with a very fast and flexible cargo-handling system and able to accommodate a mixture of commodities, not restricted to rolling units but able to load all goods movable by fork-lift truck and also, of course, container.

In the early 1980s, when worldwide transportation of new cars grew quickly, it became apparent that it was possible to combine cars and heavy vehicles often named “high and heavy cargo” and the modern “pure car and truck carrier” (PCTC) became a workhorse. While the PCTC trades mainly in the deep-sea trades, the short-sea trades became increasingly competitive and pure trailer vessels with good speed and manoeuvrability were developed for European trades as well as domestic Japanese trades. For the shortest connections with only five to 10 hours’ sailing, such as the English Channel, it was evident that loading and discharging by stevedores was too slow, and the solution was to let the truck driver drive on and off and sail with the vessel. As these vessels had to carry more than 12 drivers/passengers they became by definition passenger vessels and can also cater for car passengers and were later named RoPax vessels.

There are specialized shipbrokers for the chartering and sale and purchase of these vessels and some even specialize in only one of the ro/ro segments.

Lack of tonnage occurred in the mid-1990s, when a new batch of new-buildings were contracted and also RoPaxes started emerging from yards in the Far East.

Today worldwide there are about 36 million trailers/trucks and 225 million cars being moved by ro/ro and RoPax vessels annually and the market is increasing.

The liner market

Liner traffic is a firmly controlled activity where remuneration is geared more to the long term than to single voyages. The freight rates in the tariff are by definition not subject to the large variations that characterize the so-called open market. Nevertheless, liner traffic is susceptible to market variations, depending on availability of cargo and load factors on each voyage.

Fig. 1. The load factor

$$\text{Load factor} = \frac{\text{loaded cubic}}{\text{available cubic}} \times 100(\%)$$

The load factor indicates how much of the available cubic capacity is made use of.

There is an intermittent need for time-chartered tonnage, which will be either expensive or cheap depending on the supply of ships and employment terms, especially the point of redelivery. When the market is low, such extra vessels may be trip-chartered at a low daily hire, but the availability of cargo for the scheduled sailing, which has to be performed anyway, may not be very good. During such market conditions the competition from so-called outsiders often gets stronger, as these may enter a liner trade for only a number of trips, accepting freight rates that are lower than the liner tariff rates just to keep the ships going until the open market conditions improve again.

Liner shipping is often carried out within a liner conference, which is a type of cartel for a particular market, see further below, page 102. Some lines belonging to a conference or a so-called Rate Agreement, or, indeed, all lines in a conference may join together to form a freight pool or a consortium.

Liner vessels get the larger share of their cargo through contracted liner agents, most of whom do not work as shipbrokers in the dry cargo market. A liner company may also book basic part-cargoes and interesting special commodities just to fill empty space. This is often done on charterparty terms through broker connections in the open market. Imbalance in cargo volumes between the outward and home-ward legs of a round voyage often makes the lines competitors with the 'tween-decker tonnage working the open market from the same areas.

Liner operators are usually more involved than other shipowners in the improvement of cargo-handling techniques and they often participate actively in developing those ports at which they call regularly.

The small ship market

As mentioned previously, there is a large number of vessels of 10,000 tons and under. Most of this tonnage is engaged in short-sea and coastal trading, and this

market has its own information system and channels of communication which function independently, the market variations not necessarily coinciding with those of the market affecting the ocean-going tonnage. Coastal shipping is often reserved particularly for vessels of the coastal state. Many shipping companies carry on independent trading with smaller-sized vessels, but the trend is now to employ small single and 'tweendeckers in some sort of regularly scheduled feeder traffic. The result is that these vessels find themselves in competition with other carriers in the short-sea trade, including larger ships carrying part-cargoes as well as road and rail traffic.

One may find typical feeder companies looking for employment in the open market depending on the casual need. It is, however, also common for ocean liner companies or a forwarding agent or charterers who trade with their own products to operate feeder ships as a part of their transport scheme.

Owners and operators of coasters and feeder vessels frequently work together, pooling their fleets and administrative resources in order to undertake contracting and to optimize scheduling, employment distribution and earnings.

Some owners specialize in tailoring their ships and operation for so-called industrial shipping, in close co-operation over a longer period of time with a big exporter/importer or industry to provide an integrated link in the industry's overall logistics system.

Special markets

In addition to the above-mentioned types of vessel there are quite a number of special ships which meet various special needs. Among such vessels the following can be mentioned:

Heavy-lift carriers

Some companies have specialized in heavy-lift cargoes and technically complicated transports, where the movement between quay and ship is the most difficult part of the operation. For such purposes vessels must be built with special demands on stability and constructional strength in mind, particularly with regard to vessels' gear.

Barges and pontoons

These carriers are also used for the transport of heavy material, for example, ready-built drilling rigs, but they are also used as floating quays, as feeders in short-sea traffic and as discharging platforms between an ocean-going ship and the quay. A combination of logistics is the tug-barge system, where a detachable pushing tug unit is used as an engine for a number of "cargo-hold" units.

Tugs

The demand for towing vessels has grown with the increased use of barges and pontoons, especially by the offshore industry. At the same time, towing work for the merchant fleet is becoming less frequently demanded.

THE TANKER MARKET

One characteristic of the tanker market has been the dominating position held by a comparatively small number of big charterers: that is, the large oil companies. The number of smaller private firms (often known as “traders”) and state organizations engaged in the chartering of tankers increased considerably during the 1980s. Now we are seeing a concentration of fewer and larger entities, with the number of traders decreasing. The comparatively small number of loading areas and the offshore loading terminals is also typical for the tanker market, although there has been a significant increase of loading places since the late 1990s. From the early 1990s we have also seen increasing national and international concern over tanker safety and environmental aspects, resulting in new rules and conditions for tanker owners (notably by IMO and by the USA’s OPA 90) which, in the long term, will affect the market and the marketing of tankers, especially older vessels. In addition the major charterers in the trade have introduced their own vettings. Thus, both the ship and the company running the vessel will be carefully checked and approved by the charterers before entering into a contract.

Tankers—especially those carrying crude oil—practically never get any return cargoes and are, therefore, normally forced to proceed in ballast over an ocean route to a loading area. Many shipowners prefer to place their ships on time charter for a long period, but there is also an important spot market. It is typical that the volume of spot business becomes comparatively larger during a low-market period. Throughout the years it has been typical for the big oil companies to own a considerable fleet of tankers under their management, but now the trend is for these companies to sell off and cease operation as owners. Instead, tanker owners will build vessels to charterers’ specifications and place them on long-term charter or contract with the oil company in question. In a depressed market situation these charterers may opt to play the spot market, or enter into longer engagements of maximum one-year duration only.

Since the 1950s, when the tanker market divided into a “crude” or “dirty” sector and a “product” sector, there has been a continuous trend towards increasingly larger tankers, a development which levelled out during the late 1970s. The largest are usually called VLCC and ULCC (very large crude carriers, in sizes of about 200,000–300,000 d.w. tons, and ultra large crude carriers, of 300,000–550,000 d.w. tons) which are used for the transport of crude oil. The classes of smaller and moderate sizes (Panamax of 55,000–70,000 tons, Aframax of 70,000–100,000 tons and Suezmax of 100,000–150,000 tons) may be used for either dirty or product

cargoes depending on the ship's age and status of cleanness. The smaller coaster tankers are used to carry refined products. Since the late 1970s there has been an increase in demand for handysize tankers within the 30,000–100,000 tons range, and lately also for sizes up to Suezmax. Since the late 1980s there have been a few orders for VLCC tankers.

International regulations for tanker ship safety have become much stricter, and oil pollution in any form is not acceptable—all these rules and regulations are followed by the majority of tanker shipowners competing for charters. Notably all new-build orders today for tankers are for ships with a double-hull construction. Also, from a technical point of view, the sea transport of oil is carried out in virtually the same way all over the world. Tanker charterers, tanker owners and tanker brokers are also working with elaborate and standardized documents, the design of which has been influenced by the oil companies over the years and which may be used on, more or less, a take-it-or-leave-it basis. The negotiations for a tanker charter are, therefore, less complicated than, for example, negotiations in dry cargo chartering and are normally carried out within a very short space of time.

The problems encountered in tanker chartering are, however, even greater than those found in other forms of chartering. The art is to hit the right time for the fixture at a freight level well in tune with the prevailing market. The daily fluctuations, as well as the periodical changes, normally occur very rapidly and with strong deflections, which may cause the situation to change radically from one hour to the next. This fast movement is due mainly to the quick changes in oil prices, so the chartering closely reflects the commodity trading. Owing to the comparatively limited number of parties involved in the tanker market every occurrence has a great effect, which sometimes means that one single fixture may affect the total state of the market for the day.

Within the tanker market there are also special carriers, for example, solvent and parcel tankers for liquid chemicals of various kinds. These ships can often carry a great number of such chemical products of different kinds at the same time. The size of this type of vessel about equals that of the product tanker. There are also small chemical tankers for coastal trading. A solvent tanker may also be used for the carriage of various refined petroleum products. The gas tankers form a special class and the vessels are called LPG (liquefied petroleum gas) and LNG (liquefied natural gas) tankers in accordance with the product the ships are constructed to carry.

Vegetable oil has recently become a popular product for tankers. The product is today used mainly within the food industry but owing to increasing environmental consciousness the industry is also showing interest in the vegoil as biofuel. Thus, the segment 20,000–50,000 ton tankers has found an interesting cargo, that is, bringing new-builds back from southeast Asia to the Continent.

A field related to the tanker market is the *offshore sector*, concerned with exploration and exploitation of oil in the open sea with more or less permanently anchored drilling vessels and drilling rigs. During the last decade a special freight market has developed for such “ships” and for their offshore servants, the supply ships.

The activity on the offshore market varies and consequently so does the market for supply vessels. To some extent these ships can compete for cargoes with smaller tonnage in the short-sea trade and they may also be used for towing work. There are also the technically very sophisticated shuttle tankers and the so-called buoy loaders and the FPSO and FSO (floating production storage and offloading and floating storage and offloading) units, respectively, which are normally built by owners exclusively for operation under a contract with a specific oil company during a long time period. These types may in certain situations be freed for competing in the open market with the regular tonnage.

THE “COMBOS”

The combination carriers of ore/oil type and ore/bulk/oil (OBO) have a special market position, although not always in the way originally intended. The intention was that those ships would perform combined voyages in a trade with, for example, dry bulk cargo in one direction and with tanker cargo for the return leg, thus improving the round voyage result by reducing the time in ballast and increasing the earning time. Such an operation requires a high degree of flexibility and skill in the owner's management and teamwork of staff and, indeed, there are owners and operators specializing in such trading. The great majority of “combo” owners, however, prefer to use their ships either as pure tankers or as pure bulk carriers, depending on which market is offering the best revenue at the time. This development was also created by the difficulty of combining freight contracts and also by such practical problems as costs for cleaning the ships' holds between the different commodities. Thus, the combination carriers increase the supply of tonnage on the market where they are being worked for the moment and can, therefore, contribute to weakening an upward trend in freight levels or strengthening a downward trend. This impact of the tanker on the dry markets—albeit that a relatively small number of ships is concerned—makes the operators of pure tankers or dry bulk vessels watch carefully to try to predetermine the next move by the combo owners. This influence is now gradually decreasing since very few combos have been built during the last decade, and the older ones are being scrapped without replacement orders to the yards.

THE REEFER MARKET

Large-scale reefer (refrigerated ship) trading is basically a worldwide operation, but this market is nevertheless very much a closed one. There are only a few owners, operators and reefer brokers who devote themselves to this freight market. Since a 1999 peak with 895 vessels, the fleet has steadily reduced, and today stands at 790 ships of 100,000 cbf size or bigger. The charterers are often very large organizations, privately owned as well as governmental. In contrast to what is normally the method

in dry cargo chartering, a reefer charter is frequently made directly between owners and charterers without the assistance of brokers. Nevertheless, there are many connections and similarities between the reefer and the dry cargo markets.

Reefer ships are employed to a large extent in contract trading, but there is also an important spot market. The operation is strongly influenced by large seasonal variations in the supply of cargoes. The reefer market is, however, also characterized by sudden changes and at the same time the contractual engagements require very strict and careful scheduling.

The loading areas are scattered all over the world but the discharging areas are concentrated primarily in Europe, the USA and Japan. Bananas, and to a large extent meat, are transported year round, while fish, citrus and other fruits, vegetables and potatoes are seasonal. The demand for reefer tonnage normally reaches a peak during the first half of each year when the products of the southern hemisphere are bound for shipment to Europe.

Reefer trades are practically always one-way routes and generally speaking there is a huge imbalance, not only geographically in the distribution of the loading/discharging areas, but also seasonally with the so-called high season during the first half of the year and a low season during the balance of the year. In addition to this there are weekly and daily variations in demand for transport depending on crop outcome in the various areas. Sudden problems in some supplying areas may cause drastic re-routing of reefer vessels more or less overnight but, at the same time, the shipping programmes for the individual routes follow very strict schedules and require perfect timing in arrivals and departures. Of course, reliable technical equipment and great skill in cargo handling and treatment during the sea voyage are also necessary.

Economy is achieved by reducing ballasting to a minimum and by always using a vessel's maximum cargo capacity. In order to reduce the time and costs in port, all the major reefer trades are now based on palletization.

Most reefers being built today have permanent fittings on deck and on top of the weather deck hatches for reefer containers, to increase the carrying capacity and to meet special requirements from customers. This also enables the owners to compete with the regular lines, or even to participate more regularly in certain liner trades.

It is customary for reefers to carry cars and, if the freight levels permit, even bagged cargoes, paper, lightweight unitized cargoes, etc., and also dry containers. The vessels will then compete with the 'tweendeckers and multi-purpose ships operating in the open market.

The major competitor to specialized reefer ships is the ever-growing container fleet. Since 2000 container vessels have had an average of 16 per cent reefer capacity. While there were 16 reefer ships on order as at mid-2008, for the same period the container fleet had an order book of 1,324 vessels. In 2008, the average age of the reefer fleet was 21 years compared with 11 years for the container ships. In mid-2008 about 18 per cent of the reefer transport at sea was covered by the reefer ships. It is, therefore, estimated that the specialized reefer provision of overall

reefer capacity is forecast to a maximum of about 11 per cent at the beginning of 2013.

THE CAR CARRIER MARKET

There are many similarities between the reefer market and the market for car-carrying vessels. The number of vessels employed on a worldwide basis is about 600–700. It is a very closed market using very little broker assistance, and business is concluded mostly on the basis of long-term contracts between a few operators (five operators control 65 per cent of the fleet) and exporting companies. The market variations, however, are generally non-seasonal and follow a rhythm of their own with rather big differences—not so much in freight levels but in demand for shipping space. So far the market cycles have been of about two to four years' duration.

The most important trades with fully assembled vehicles are from Japan and South Korea to the United States and Europe and vice versa, and from Europe to the United States, and there is also an inter-European trade covering important volumes. Secondary trades in respect of volumes carried are from Europe and the United States to countries in Africa and the Middle East and Central and South America and from Japan to the same areas, plus Australia. Of course, China is also starting to play an important role both as an exporter and as an importer of new cars. Yearly there are about 13 million factory new cars being moved across the seas.

Most vehicles are medium-size passenger cars but lorries, trucks, tractors and buses are also carried. This sector of the market is increasing, as well as the trade in used cars from Europe and the USA to Africa and South America. In addition and parallel to the trade of fully assembled vehicles there is an increasing volume of car parts, so-called “cars knocked down” (CKD) for assembly in factories in the receiving countries. These cargoes so far have been carried by the lines.

The overseas transportation of vehicles in the big-volume trades is taken care of by very large purpose-built vessels, so-called “pure car carriers” (PCC) and the car carriers specially built to accommodate large vehicles, “pure car truck carriers” (PCTC). Each has a capacity of 2,000 to 6,000 “car equivalent units” (CEU), although we are now seeing the “large car truck carrier” being introduced which is able to accommodate 8,000 CEU. The loading/unloading of a PCC/PCTC is done by ro/ro methods and is extremely fast.

All mass transportation of fully built-up vehicles is done by the ro/ro mode in PCCs, ro/ro ships and ferries. One good reason for this is that shippers of cars normally refuse shipment by lo/lo tonnage when ro/ro is available.

Smaller volumes of cars (from just a few up to about 100–150 per shipment) are taken care of by the lines at liner tariff freights, but for trades where the volumes are increasing up to anything between 200 and 900 units per shipment the charterers may sometimes employ reefer tonnage, which, with many 'tweendecks (“multi-deckers”), can provide the deck space required.

The PCTC types, like the modern reefers, appear from time to time and more or less regularly in trans-ocean liner trades, as and when suitable for the rotation and positioning of the vessels in a worldwide transportation system. We also see car carrier owners enter into a closer co-operation with their customers, by undertaking extended services such as providing feeder systems for distribution from a base port and by setting up special workshops in the discharging ports where the cars are being fully prepared and serviced in such order that the vehicles can be delivered directly to the car dealers' showroom.

The vessels are often built against 10- to 15-year time charters, with a practically non-existent second-hand market. The order book shows a preference for larger ships, the majority being 6,000 CEU or more.

THE PASSENGER MARKET

The big passenger ships in trans-oceanic liner traffic have now, in practice, vanished. Large-size tonnage with accommodation only for passengers is now primarily engaged in cruising. Most passenger vessels are operated in short-distance trade with consecutive trips on tight schedules—the so-called ferry traffic. These ships mostly have a good capacity for rolling goods and they are a supplement to the pure cargo ro/ro ships operating in the same trading area.

The market for passenger ships is very much dependent on seasonal variations; the working of those vessels in the open market is often done with the assistance of the brokers specialized in ro/ro chartering and employment is practically always fixed on a time charter basis.

THE SALE AND PURCHASE MARKET

An important part of shipping concerns the sale and purchase of ships. The general freight market and the so-called second-hand market for ships have considerable mutual influence. It is important to follow the day-to-day level of the second-hand market, as well as the state of the freight market for a specific type of vessel.

The owners watch the offers from the shipyards of new-builds, but also the supply of vessels on the second-hand market, as well as the development of scrap prices for old ships. Such details give useful information about the supply of tonnage for a few years ahead and may have a decisive influence on the long-term development of the freight market. During a period of low market activity it is especially interesting to observe whether the existing tonnage is laid up, is sold for trading under low-cost flags, or is scrapped.

The second-hand market varies largely in conjunction with the freight market for each specific type of ship. Theoretically, an owner would buy ships during a low-market period and sell vessels when the freight market rose. Owners, however, tend to do the reverse and there are several reasons for this. Among other things, this has to do with the need during a period of recession to sell in order to strengthen the

liquidity position. One good reason is, of course, that the necessary financing for purchase or ordering new-builds is not normally readily available from banks and other lending institutions during a low-market situation, even if market conditions are expected to improve within the near future.

FREIGHT DERIVATIVES

The “Baltic” developed a new and important role as an international freight exchange centre when, in 1985, the Baltic International Freight Futures Exchange (BIFFEX) was inaugurated. On this exchange there were two daily sessions for trading charterparties and contracts which were to be performed at some later date (up to two years) against a weighted freight index. This index, the Baltic Freight Index (BFI), reflected the present market and expectations for the market’s development in the future. By BIFFEX trading, owners, charterers and other parties on the shipping scene, including, of course, speculators, could protect themselves (“hedge”) against the risk of, and play on, the volatility of freight rates and time-charter hires.

In 1991 an additional system was introduced, the Forward Freight Agreement (FFA). This system met the need to make contracts that were more specific rather than to settle against a global freight index. The FFA’s are traded principal to principal as opposed to the BIFFEX which was traded via an exchange. Should more security for the performance of the contract be required the FFA deal can also be done through a clearing-house such as the Maritime Exchange (IMAREX) in Norway or the London Clearing House.

A buyer (charterer) and a seller (owner) agree to trade an FFA contract. The Baltic today produces some 39 daily assessments broken down into wet and dry so there is a variety of cargoes and routes to be chosen from. Through their FFA broker they will agree:

- the agreed route;
- the day, month and year of settlement;
- contract quantity; and
- the contract rate at which differences will be settled.

The actual settlement price (the future freight level) is normally obtained by taking an average of the last seven indices of the agreed month and route.

Assume that the buyer (charterer) has a Panamax cargo Continent/Far East to move two months ahead from now and is concerned that the T/C market will go up within the near future. The seller (owner) has four ships coming open on the Continent in the relevant period and is interested to safeguard a minimum T/C rate for at least one of his ships. Negotiations start and the parties finally agree at US\$12,800 per day. Thus, settlement will be against Route P2A of the Baltic Panamax Index.

Two months later, at the date of settlement, the average of the last seven indices turn out to be US\$14,000 per day, which is higher than the agreed rate. Thus, the seller pays the buyer the difference of $\text{US\$}1,200 \times 65 \text{ days} = \text{US\$}78,000$ that the charterer will use to offset against the high rate he will have to pay for a vessel on the spot market. The shipowner should be able to fix his ship close to the US\$14,000 which is the ruling market and, although the shipowner is losing some on the FFA, he has safeguarded an income for one of the ships. The other three ships will benefit from the better market.

The above example is a classic and simple form of how the FFA trade works. It should be noted though that an FFA is often tailor made to suit an owner's or charterer's particular need for a hedge.



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CHAPTER 2

THE STATE OF THE MARKET

There is a difference between the liner-bound freight market and the open freight market. The latter market is the market where tonnage is fixed voyage by voyage—the so-called spot market—where the buyers of sea transport find the additional tonnage required to comply with all the occasional increases in demand for transport. The open market also includes a time charter sector and the important sector covering other more long-range contractual engagements of various natures.

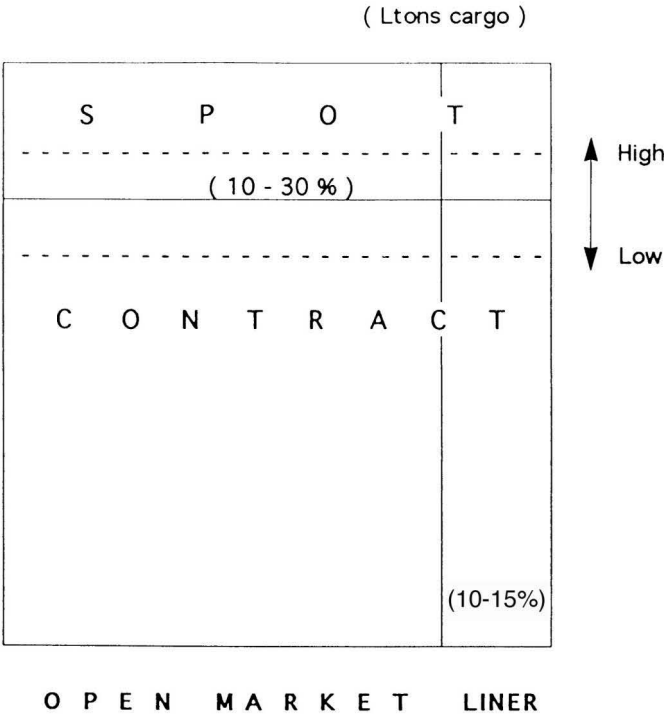
It has been calculated that about 50 per cent of the world volume of goods transported by sea is fixed in the open market. The balance is taken care of by the liner services in their strictly directed and scheduled traffic with controlled freight terms and conditions and freight levels. It is estimated that the spot market volume is about 10 to 15 per cent of the total open market volume. This sector gets an increasing supply of ships during periods of general economic recession, when there is a low demand for sea transport.

The open market is influenced by the “law” of supply and demand, but it would be an over-simplification to state that the market is generated and directed by this. The variations in freight levels are very large and this is easily seen in Figure 3, below (page 19) showing tanker market fluctuations over a period of several years. The diagram would be largely the same if notations were made for one of the important dry cargo commodities, for example, coal. Graphs showing the dry cargo market (Figure 9, below (page 36)), covering a period of about 15 years, illustrate how the market conditions follow, on the one hand, a long-wave system, which tends to coincide—but not always—with graphs for world industrial output, and, on the other hand, a short-wave system, which is irregular, but not entirely—as Figure 9 shows, there are yearly seasonal variations. The connection to world industrial activity is reflected by market rates for the two so-called leading commodities, iron ore and coal (raw materials for the steel industry), and seasonal variations are influenced by demand for ships to carry grain (including soya beans and rice), which is the third leading commodity in the dry cargo sector.

An illustration will show how operative forces work in practice in a miniature market. If, for a specific loading date within a limited area, there are 10 ships open for employment, but there are only nine cargoes offered, then it is very likely that

none of the vessels will obtain a higher freight rate than the lowest rate that any one of the respective shipowners is willing to accept. In the reverse situation, where there are 10 cargoes available but only nine ships, one can expect every ship that is fixed to obtain better terms than the preceding one.

Fig. 2. World shipping market, ships' employment

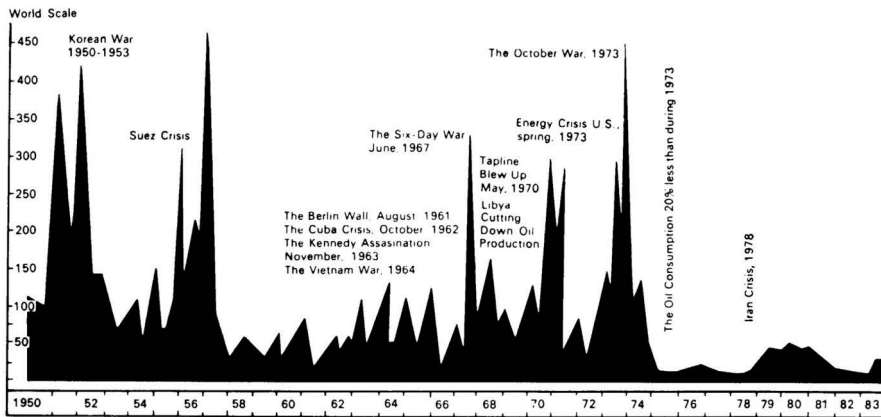


NOTE: This diagram shows a rough comparison between quantities carried in regular liner trades and in the open market, and also between quantities fixed in the spot market versus quantities carried under some kind of contractual or long-term engagement. Normally the spot market portion tends to increase during times of low market rates.

When the larger number of cargoes or employment of ships of world freight markets have been negotiated, more or less secretly, in direct talks between the owners and charterers, for long engagements under contracts or time charters, there remain a number of cargoes looking for ships and a number of ships looking for

employment. The latter constitute the so-called spot market. This situation develops and changes on a day-by-day basis; it could affect any geographical area and covers the whole spectrum of types, sizes and features of ship. It is this market situation, the fixing and the terms currently obtained in such spot market sectors, that is being reported continuously by brokers and shipping papers. In the market situation pictured below, would we expect the market to go up or down?

Fig. 3. Various events of worldwide importance: effect on freight levels (tanker market)



Note: This graph is history now but the shipping market still reacts quickly to warlike actions. However, today, when information is readily available to all parties, there tend to be fewer surprises and the volatility in the freight market is reduced.

Factors influencing the general freight situation and the development of the open market are, except for the general state of the world economy, sudden changes in demand for specific commodities, an economic boom within special limited market areas, state of war, closure of important routes, crop failure, extreme congestion in important ports, oversupply of specific types of ship, unusually late or early closure of ice-bound waters, etc.

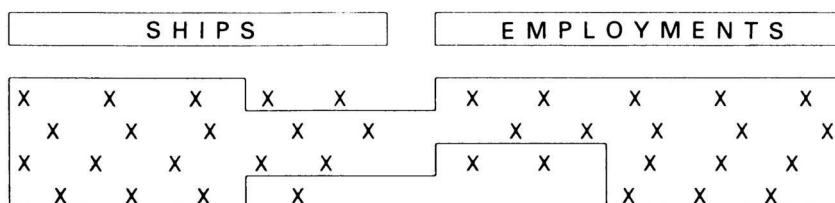
In 2008 we saw a dramatic increase in pirate attacks near the African east coast. Shipowners were faced with additional “kidnap and ransom” insurance premiums as well as war risk bonuses to be paid to the crew. For the voyage from the Continent to the Persian Gulf some shipowners have even considered re-routing the vessels via the Cape of Good Hope to avoid what was almost deemed to be a war zone.

It is practically impossible to predict with any degree of certainty future developments in the freight market. In general, periods of low freight market conditions are substantially longer than periods when high freight rates can be obtained. There is really no such thing as a “normal” market level and it would be more accurate to say that the freight market constantly oscillates between extremes. Certain factors, for example, political involvement in the shipping field, sometimes make it possible

for those concerned in the main bulk trades to anticipate a reduction in the open market's share of the total transport volume to the advantage of enclosed, strictly controlled, transportation systems.

There are always, even during periods of general economic recession, areas where there is a more or less temporarily high demand for tonnage. In 1977, for instance, there was a great excess of tonnage in the dry cargo and tanker markets. A tendency to improvement in the state of the dry cargo market was counteracted, for example, by continuing deliveries of bulk carriers from the shipyards. At the same time, however, there was a strong demand for ocean-going ro/ro vessels and reefer ships, which thus obtained very high time charter rates.

Fig. 4. The spot market



NOTE: This is a simplified picture of the open market status at any one time. The ships and employments within the frame are finding each other directly in some kind of long-term engagement, in other words they are fixed away and covered and the ships concerned are trading. The ships and employments remaining open outside the frame constitute the spot market at this particular time and in this specific area or market sector. Brokers will be trying to match the respective Owners and Charterers. The freight rates and other terms obtainable will reflect the unbalance between supply of ships and demand for transport. That status will tell brokers and other parties involved whether the market is going up or down, and the circulated fixture reports and market gossip will advise about the freight levels and terms actually fixed.

Other factors which contribute to the uncertainty in forecasting, and which have had and will have a decisive influence on the freight market development, are changes in economic conditions in countries such as Russia, the USA, Japan and now certainly China. A farmers' strike in Argentina creating a massive congestion in the Argentinean ports certainly has an influence in the freight rates, as do flooding which affects the production in Australian coal mines. Another typical example is the United Nations' embargo on Libya and Iraq, which had rather a sudden impact on the markets. Information about such matters tends to hit the shipping market suddenly, although not quite unexpectedly.

During a general low freight market period every sign is noted which may

indicate a change toward an increase in demand for sea transport, such as the state of the general economic world market, the development of the general political situation, the market trends within special sectors, for example, steel output, the production of cars and the outcome of the harvest in important consuming areas. When there seem to be small but firm indications of higher freight rates shown simultaneously by most important market indicators, an exception is created which in the beginning is weak but which grows stronger and stronger among the parties in the shipping business. It is in the interests of charterers and shippers to try to belittle such signs of forthcoming changes, while shipowners then take an attitude of wait and see. If it becomes evident that there is substance in these market trends, charterers become more and more active in the time charter markets, trying to secure long-term contractual engagements at low freight levels. Thereby the supply of tonnage on the spot market will decrease and the freight levels generally start to rise slowly.

If there arises a sudden increase in demand for tonnage in a special trade, as for instance the ore trade between Australia and China, a scarcity of tonnage will occur in other areas and in other trades dependent on the same type and size of ship. The rising trend in freight levels will then become further accentuated. At this point, certain psychological factors will start to contribute to the development of the market. Charterers, in fear of running into a situation of acute scarcity of tonnage, will try to conclude their shipping arrangements as soon as possible. Owners can ask for increasingly higher freight rates and if, in addition, a sudden political crisis arises, then those interested in the shipping market may find themselves in a real freight boom. The trading in freight future agreements (FFA) will no doubt have an impact on owners' expectations of the market. Before fixing away the ship for a period employment an owner will carefully study the FFA figures for the time span in question.

A frequent consequence of such a development is that the owners of older vessels, which have been laid up during the low market period, will start trading their ships again instead of sending them to the scrap yards. Little by little owners and charterers will now start to realize that they can dispose of transport capacity which is too big and, at the same time, too expensive. They will now start to offer part of the previously time-chartered tonnage for employment on the spot market or for time-charter engagements. Another factor which will affect the market with a delay of some two or three years is that a number of owners will now order new-builds, which, if they have bad luck, will be delivered during the next period of a low freight market.

A recession in the shipping market is now predictable, although its precise timing may not be possible. Owners will show an increasing interest in fixing their ships for long-term engagements and freight levels will move downwards. Charterers will hold out to obtain even lower freight levels and, as suddenly as the freights start to rise to very high levels, the market will drop. In the past when the conference system was still in full force the container freight rates would hold out although the volumes