

An aerial night photograph of a busy port. A large container ship is docked at a pier, illuminated by bright yellow lights from a gantry crane. The ship's deck is covered with stacks of colorful shipping containers. The water reflects the lights, and the overall scene is a mix of blue, yellow, and red tones.

Market Intelligence

SHIPPING 2021

Global interview panel led by Kevin Cooper

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Japan

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Adrian is recognised as a leading practitioner for shipping and energy infrastructure matters and is ranked in *Chambers* 2021 for 'International Asset Finance' and 'Projects & Energy' and *The Legal 500* as 'Leading Individual' for 'Projects and Finance' and 'Banking and Finance'.

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Kosuke is recognised as an industry expert in many legal directories, including *Who's Who Legal* and *IFLR 1000*. In 2021, he is also recognised as an IFLR Asian Future Leader and is admitted in both Japan and New York.

Ashley Sutton is an associate in the Tokyo office of Nishimura & Asahi and is a member of the firm's banking and finance group. Ashley has significant experience advising clients on cross-border asset financings, particularly in the shipping and aviation sectors.

1 | What is the current state of the shipping industry (including service providers supporting it) in your country?

There has been a decline in new shipbuilding orders in Japan. According to the Shipbuilders' Association of Japan's statistics for 2021, while there were 348 new orders in 2019, 2020 saw only 188 new orders, which was similar to the number of new orders in 2016 (183). Notwithstanding this, the Japanese shipping industry remains in good shape overall. Demand for shipping is high and Japan is taking the lead in developing new green technologies.

2 | What are the prevailing shipping market trends affecting your country? What has been the impact of the covid-19 pandemic?

Despite the challenging environment, Japanese shipowners are in a good position as container shipping prices have reached record highs due to, among other reasons, increased consumer demand during the covid-19 pandemic. The Freightos Baltic Index, a benchmark for major shipping routes, tripled from 2020 to 2021 to nearly US\$7,000 for a voyage from China to the west coast of the United States. Similarly, a voyage to Europe has exceeded US\$10,000, compared with just US\$1,600 in 2020.

However, the covid-19 pandemic has affected Japanese and non-Japanese companies alike with shipping delays and disruption to supply chains. For example, Toyota Motor Corp, one of the largest automobile manufacturers in the world, had to halt operations at plants in Thailand and Japan because it could not obtain parts.

3 | Are there any recent domestic or international political or legislative developments that may have an impact on your country's shipping market?

Domestic legislation

A series of legislative bills aimed at strengthening the maritime industry were passed in May 2021. These include amendments to a number of maritime acts in Japan, including the Maritime Transportation Act, the Coastal Maritime Business Act, the Shipbuilding Act, the Ship Safety Act and the Mariners Act. The main focus of these bills is to (1) strengthen the competitiveness of the shipbuilding and maritime business sectors in Japan and (2) reform the work habits of mariners and improving the productivity of the coastal maritime business.



Adrian Joyce



Kosuke Shibukawa



Ashley Sutton

“Despite the challenging environment, Japanese shipowners are in a good position.”

“An increasing number of Japanese lenders and lessors are prioritising environmentally responsible shipping steps.”

Strengthening the competitiveness of the shipbuilding and maritime business sectors

The legislation includes measures to support the implementation of shipbuilders' plans to improve productivity or restructure their businesses, including the availability of governmental subsidies, loans and tax incentives.

As for measures related to the ocean-going and coastal maritime businesses, when a maritime company plans to introduce a high-quality ship that is safe, has low environmental impact and contributes to labour efficiency in production, and the government approves such plan, the legislation will provide for the provision of governmental support, including loans and tax incentives.

The government will support the plans of domestic shipbuilders to reduce costs and develop new shipbuilding technology, and will also support maritime companies planning to introduce environmentally friendly vessels and vessels for offshore resource development, thereby supporting the two pillars of Japan's shipbuilding and maritime industries as a whole.

Reforming the work habits of mariners and improving the productivity of the coastal maritime business

In the area of mariner-related measures, the aim of the legislation is to ensure the more efficient labour management of mariners. In the area of coastal shipping, the aims are to improve the trading environment for coastal shipping, increase productivity and promote the introduction of new technologies.

The shipbuilding and maritime industries are traditional industries with a long history in Japan, and mitigating the effect of an increase in the average age of mariners and employees is a priority. In order to attract and retain a younger workforce, it is necessary to improve the work and business environments, and the legislation aims to formulate such a system.

Green shipping

An increasing number of Japanese lenders and lessors are prioritising environmentally responsible shipping steps including the adoption of the Poseidon Principals by various Japanese companies, including Sumitomo Mitsui Trust Bank, Limited and Sumitomo Mitsui Finance and Leasing Company, Limited.

As part of the International Greenhouse Gas Zero Emission Project established in 2018, Japan has set its target to realise commercial operation of a zero-emission ship by 2028. Four concept designs have been drawn up for zero-emission ships under the name C-Zero Japan series and utilising different fuels, namely: (1) liquid hydrogen, (2) synthetic methane and LNG, (3) ammonia, and (4) an onboard CO₂ capture and storage system from exhaust gases used together with a methane-fuelled propulsion system.

The International Maritime Organization (IMO) has also set a target of halving international shipping's greenhouse gas emissions by 2050. Towards this goal, LNG as a marine fuel is being positioned as a transitional bridge solution. LNG-fuelled ships are continuing to increase in number and many Japanese shipyards are involved in developing LNG as a fuel in newbuilding projects for all ship types and designs. For example K Line has just announced it will order eight 7,000 units class car carriers fuelled by LNG to be delivered between 2023 and 2025, which follow the delivery of its first LNG-fuelled car carrier 'Century Highway Green' in March 2021.

In addition to LNG-fuelled vessels, Japanese shipyards are also involved in developing other fuel sources. In 2020, Japan's Imabari Shipbuilding developed the world's first 180,000 deadweight tonnage (DWT) LPG-fuelled bulk carrier. Bulk carriers that use wind power are also being introduced. Japan's Mitsui OSK Lines and Tohoku Electric Power Company are building a 99,000-DWT coal carrier at Oshima Shipbuilding, which includes a hard sail wind power propulsion system, and the ship will begin operations in 2022.

Similarly, Kawasaki Heavy Industries has built the world's first ship to transport hydrogen, Suiso Frontier. The prototype vessel is undergoing sea trials, with a demonstration maiden voyage from Australia to Japan expected in the latter part of 2021. The company is aiming to build a commercial-scale hydrogen carrier by the mid-2020s.

Vessel automation

In addition to green goals, Japan is also aiming to realise the automation of vessels by 2025 and to have half of its coastal ships replaced by crewless vessels by 2040. To achieve this goal, various types of demonstrations will be conducted. For example, in 2022, demonstrations will take place on a 740-GT coastal containership Suzaku. While the vessel will be crewed, as currently required by Japanese laws and regulations, its operation will be automated.

International cooperation

In recent years, Japan has also been promoting international cooperation to ensure maritime peace and stability and has been providing Japanese shipbuilding technologies for the improvement of international maritime safety capability, as well as regional public transportation and other maritime services. Between 2013 and 2020, Japan provided 38 vessels to 13 countries (worth ¥95.7 billion) under the Official Development Assistance programme.

4 | What are the key regulatory and compliance issues for your country's shipping market? What's coming up in the near future?

General

There are a number of Japanese laws broadly covering marine transportation business in relation to vessels. For example, the Ships Act stipulates the requirements for owners of Japanese-flagged vessels, the Marine Transportation Act sets the rules on marine transportation and ship chartering businesses, the Mariners Act sets the rules on working conditions for crew on Japanese-flagged vessels, the Ships Safety Act stipulates standards for the navigation of vessels for the safety of human life and the Shipbuilding Act stipulates requirements for the shipbuilding business located in Japan.

Further, in many cases, prior notification to the Ministry of Land, Infrastructure, Transport and Tourism or its local agency is required in relation to the transportation of passengers or cargo in Japan. In particular, if you intend to operate a coastal shipping business, you should be aware that the Coastal Shipping Business Act shall be applied to such business.



Registration

Under the Ships Act, there are statutory requirements for owners of Japanese-flagged vessels, which limit ownership to: (1) the Japanese government or public authorities; (2) Japanese nationals; or (3) legal entities incorporated under Japanese law, of which the representative director and two-thirds of the executive officers must be Japanese nationals.

Registration of ownership or mortgages on Japanese vessels takes place in accordance with the Ships Act, the Ship Registration Rules or the relevant regulations. In terms of maritime liens and ship mortgages, which concern financiers, Japan has ratified neither the International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages of 1967 nor the International Convention on Maritime Liens and Mortgages of 1993. Enforcement of liens and mortgages on ships is dealt with under either the Civil Code or the Commercial Code of Japan. Chapter 3 of the Commercial Code (maritime law) broadly covers commercial transactions or issues concerning shipping, maritime and admiralty.

Safety and environmental standards

When entering the shipping market in Japan, both foreign and Japanese vessels must meet safety and environmental standards based on the Ships Safety Act. The Ships Safety Act prescribes requirements similar to those of the International Convention for the Safety of Life at Sea and other international conventions ratified by Japan, but also contains more stringent requirements. In addition, Japanese vessels must also satisfy the requirements under the International Convention for the Prevention of Pollution from Ships (MARPOL), which are implemented by government ordinance and similar rules.

As the amendment to MARPOL took effect in January 2020, many vessel operators and shipowners have started equipping their vessels with scrubbers for emission gases. Although scrubbers will form part of vessel, in Japan there are legal issues regarding whether scrubbers installed by an operator, or a person other than the vessel owner, will form part of the vessel and the property of the vessel owner or remain the property of the operator or other third person.

Although not specific to Japan, the IMO has decided that the greenhouse gas emission standards will take effect in January 2023 and will not be postponed. This is an urgent matter for Japan's shipping and shipbuilding industries, especially for ocean-going vessels.

5 | What are the shipping industry's current sources of finance? How do you predict they will develop, and what are the advantages and challenges to financing a vessel in your country?

Bank debt

Like other countries, bank debt is a major source of finance in the Japanese shipping industry. Major shipping companies commonly raise funds through loans from banks for ordering and purchasing their fleet vessels. Ship loans to ship-owning companies are often full-recourse loans but in some cases limited-recourse loans secured only by the ship and related project assets may be acceptable to Japanese lenders. Most of the principal Japanese international and domestic banks and leasing companies are experienced in ship finance matters.

Japanese operating lease with call option

In ship finance, Japanese operating lease with call option (JOLCO) transactions are often adopted as a financial tool by ship operators. The prevalent structures are either that of a silent partnership or a voluntary partnership, and ownership of the vessel is held by the operator or the voluntary partnership. A call option by the charterer to purchase the vessel is granted under the charter agreement, and the

charter and loan will be back-to-back. In recent years, the number of cross-border JOLCO transactions – where ships are owned by Japanese partnerships or special purpose vehicles and then chartered to non-Japanese shipping companies – has been increasing, and this market remains solid despite the covid-19 pandemic. Using a similar structure, JOLCO transactions in relation to containers are also being arranged by Japanese and non-Japanese shipping companies, lease companies, and financial institutions.

Other lease financing

As well as JOLCOs, Japanese leasing companies continue to offer and arrange a variety of lease financing options for both Japanese and foreign customers.

Investment funds

Although there are fewer funds in Japan compared to other jurisdictions, Japanese investment funds specialising in ship investment also provide money to shipping companies for expanding their fleets.

Recent changes to the Commercial Code of Japan

An amendment to the Commercial Code of Japan in relation to transportation and maritime law came into effect on 1 April 2019. With respect to ship finance transactions, in accordance with the amendment, certain types of claims, such as accrued freight charges and expenses for preservation after judicial sale or at last port, are no longer covered by maritime liens. Also, the term 'time charter agreement' was newly defined.

6 | Have there been any recent significant domestic or foreign court decisions or arbitration awards that impact on your country's shipping market?

The oil spill accident of a Cape-sized bulk carrier in Mauritius in August 2020 and the stranding of a 24,000 TEU container ship in the Suez Canal in March of this year were both high-profile incidents involving vessels owned by Japanese shipowners. Fortunately, neither incident appears to be contentious at present and neither has become litigious, despite both having the potential to negatively affect the Japanese maritime industry.

Both ships involved in these incidents were owned by Japanese shipowners, and were on time charters, meaning the shipowners faced liability for the incidents. Although details of how each incident was settled between the parties involved have not been published, many shipowners in Japan have become increasingly aware of the risks associated with such incidents, not least because of the responses of the shipowners

at related press conferences and the extensive media attention given to these incidents in Japan and abroad. Unlike the major maritime companies in Japan, Japanese shipowning companies are often not large or are family owned, despite the trend in recent times for shipowners to increase the size of the vessels they own. Following these incidents, concerns by shipowners about the potential for excessive liabilities in the event of similar incidents has grown, and in the future, some expect a growing trend among Japanese shipowning companies to use bareboat charters instead of time charters to try and mitigate similar risks. In line with this trend, Japanese shipowners are prioritising charterers with a good reputation for handling such incidents.

7 | What is the outlook for your country's shipping market? Which sectors are likely to grow, and which not?

Despite the impact of covid-19 on maritime business in the early stages of the pandemic and the subsequent struggles of dry bulk and car carriers in the covid-19 disaster, Japan's maritime companies posted record profits due to soaring container freights, mainly caused by 'nest egg demand' led by the declaration of a state of emergency and the clogging of logistics infrastructure in ports due to the decline in efficiency in port operations. This demand has in fact exceeded that seen before the 1998 Lehman shock. However, it is unclear whether this strong performance will continue after the end of the covid-19 pandemic.

The shipping market will focus on measures to lower the environmental impact of maritime operations, and with the IMO's decision on greenhouse gas emission regulations scheduled to take effect in January 2023, we can expect to see more activity in the development, construction and introduction of ships with low environmental impact, especially zero-emission vessels. On the finance side, Japanese financial institutions are increasingly participating in the Poseidon Principles, and it is expected that efforts to reduce greenhouse gas emissions by the Japanese shipping industry will be encouraged by Japanese financiers.

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The Inside Track

What are the particular skills that clients are looking for in an effective shipping lawyer?

The ability to keep up with new developments in the industry is crucial. Covid-19 has accelerated a number of long-term trends, including energy transition, green shipping and vessel automation. Clients expect us to proactively advise them on how to embrace the opportunities and mitigate the challenges stemming from these changes.

In Japan, lawyers are expected to negotiate and advise in both Japanese and English. Further Japanese law firms are expected to offer (1) specialist shipping lawyers qualified in England, New York, Singapore, Hong Kong, China and Japan, and (2) a full legal service including advisory services for M&A, tax, insurance, environmental and sanctions matters. This is in contrast to traditional and smaller specialised domestic shipping Japanese firms or non-Japanese firms whose shipping lawyers are based outside Japan.

What are the key considerations for clients and their lawyers when arranging finance for a shipping transaction?

Unsurprisingly, bankability remains a key consideration. As well as the opportunities and challenges of energy transition, green shipping and technological innovation, owners, charterers and financiers alike face an increasingly complex regulatory environment and the challenges resulting from increasing US-China tensions in the Asia-Pacific region.

What are the most interesting and challenging cases you have dealt with in the past year?

We have advised on a number of significant cases including:

- a number of green shipping matters including the market's first sustainability-linked lease financing;
- a significant number of LNG vessel and offshore projects including the first JOLCO financing of an LNG tanker;
- a government-backed investment into a shipping joint venture;
- a number of cross-border restructurings and workouts; and
- various sanctions matters.

Lexology GTDT Market Intelligence provides a unique perspective on evolving legal and regulatory landscapes.

Led by Kevin Cooper of MFB Solicitors, this *Shipping 2021* volume features discussion and analysis of emerging trends and hot topics within key jurisdictions worldwide.

Market Intelligence offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most significant cases and deals.

Covid-19 impact
Financing
Sector focus
2022 outlook