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Mr. Robert Stojek,
European Financial Reporting Advisory Group (EFRAG),
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Brussels.

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Dear Mr. Stojek,

**IASB PROPOSALS ON ACCOUNTING STANDARDS FOR LEASE
CONTRACTS – IFRS EXPOSURE DRAFT ED/2013/6 - comments on behalf
of International Chamber of Shipping and the European Community
Shipowners' Association**

I am writing on behalf of the International Chamber of Shipping (ICS), which is the principal international trade association for shipowners and operators, representing all sectors and trades. ICS membership comprises national shipowners' associations from 35 countries - from the Americas, Asia and Europe - representing around 80% of the world merchant fleet. The members of the national shipowners' associations are, in turn, the individual shipowning companies registered in that country and/or which fly the flag of that country. ICS has national shipowner associations in countries in Europe, namely: Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, and the UK. These national associations are also members of our sister organisation in Europe, the European Community Shipowners' Associations (ECSA) which represents these associations on issues concerning Europe. ICS and ECSA are aligned on this issue and these comments are therefore submitted also on behalf of ECSA.

ICS and ECSA submitted detailed comments on behalf of its shipowner members to the International Accounting Standards Board's (IASB) proposals on accounting standards for lease contracts in Document IFRS Exposure Draft ED/2013/6. These comments represented the consensus view of our membership.

Shipowners are interested in the proposals because shipping is an asset intensive industry using a multiplicity of contracts in pursuit of their business activity to hire out vessels and provide shipping services for the worldwide transportation of cargoes. These contracts have been in use, in one form or another, for decades, if not for centuries and reflect well understood principles of contractual relationships.

As a general comment, applying the terminology of ED/2013/6, under these shipping contracts those with a right of use of an asset (being the ship) are not necessarily the legal owner. Further, the use of relatively short term charter agreements (i.e., short when compared with the asset life) reflects the business models of many participants: Owners of tonnage trade it, either by voyage or term (time charterparty) to a multitude of shippers over the asset life, or by selling and buying new and second hand tonnage. These businesses are Shipowners and not financing houses. Most forms of these contracts are **service contracts** in that their purpose is to provide maritime transportation services through the provision of a ship and ship management services. They are not designed only to provide the use of the asset. Indeed, many owners and operators will have a flexible mix of owned and chartered tonnage so as to give operational flexibility, rather than to achieve a particular balance sheet presentation. At the other end of the spectrum, however, there are long term arrangements, the bareboat charters, by which the shipowner will effectively part with all control over the ship asset and the risk and liability, similar to a sale and finance arrangement. The Industry agrees that these are more accurately described as containing a lease as defined in the IASB/FASB proposals.

In our submission to IASB, we expressed concerns on the lack of precision in the proposals with regard to the definition of leases, pointing out that this could give rise to an interpretation that all contracts used within the industry could be caught within the definition and not just those which are finance arrangements. In particular, we highlighted our concern that operational arrangements such as time charters and other similar contracts for *transportation services* utilised by international ship operating companies could fall within the definition when in fact such arrangements should not be treated as leases for accounting purposes.

The new Exposure Draft **ED/2013/6** is an improvement in that the definition of lease now contains an important requirement of "control" and includes guidance as to how "control" is to be assessed. However, the recent discussions within the IASB indicate that it still considers some of the contracts, namely time charter contracts, which have hitherto been well understood to be contracts for services, as containing a lease which should be accounted for under the proposals. The Industry does not agree with this conclusion and therefore welcomes this opportunity to explain to EFRAG its view concerning in particular time charters and why these contracts are contracts for services.

Below, we provide our replies to the specific questions posed by EFRAG:

Questions

Identification of a lease

Q1 You are invited to provide examples of transactions that would qualify as leases under the proposals, but you consider to be in substance services.

The recent tentative decisions of IASB now include a clear example of a five year time charter as containing a lease. The Industry does not agree with this conclusion and considers that this is in substance a contract for services. In support of our view, we set out below the essential characteristics of a time charter.

Characteristics of a Time Charter Contract for Maritime Transportation Services

1. The Services contracted under a time charterparty for are for the shipowner to perform the carriage of goods in accordance with the charterer's sailing instructions for a specified period of time or for a particular trip. Shipowner provides the ship and the ship management services. Shipowner is responsible for management of the ship and cargo on board. Charterer is not permitted to use the ship alone. Thus the ship can only deliver benefits to Charterer when operated with the attendant services and officers and crew.
2. The ship management services provided by Shipowner involve, inter alia, the manning of the ship with officers and crew, on-shore management services, a ship repair and maintenance programme, insurance.
3. Shipowner controls significant decisions such as the jurisdiction of the ship (the flag State) – which can be changed during the term of the contract, but only by the shipowner/ operator;
4. Shipowner pays for and provides all insurances for the ship to allow it to sail in accordance with national and international convention requirements. These include insurances for the hull itself (property insurance), insurances for the crew and for third party liability (such as pollution caused by the ship, liability for cargo damaged on board due to deficiencies with ship or mismanagement of the cargo on board, liability for injury/death to crew or passengers).
5. The Charterer's sailing instructions specify, inter alia, the loading and discharging ports (the "sailing schedule"), the description and quantity of

cargo to be lifted, and ports where the ship will take on board fuel, to perform the carriage of goods.

6. When the cargo is loaded on board, the shipowner, through the Master, will issue a document, the bill of lading, for the goods loaded. This document serves as a receipt to Shipper for the goods by shipowner, even though they have been loaded pursuant to Charterers' instructions. The bill of lading serves multiple purposes: it is, as aforesaid, a receipt for the goods loaded, in the condition described at the time of loading; it is also a contract of carriage directly between Shipper and Shipowner under which the shipowner can be held liable for any discrepancies in the quantity and condition of goods between loading and discharge and for damage to the goods during the maritime transit as a result of any failings by the ship and crew in the care and management of the goods whilst on board; and finally, it is a document of title, allowing any lawful holder to take delivery of the goods on presentation of the bill of lading. Shipowner is responsible for ensuring goods are delivered to the lawful bill of lading holder and will be responsible / liable if he mis-delivers to a party not entitled to take delivery. This bill of lading contract may be transferred from shipper to receiver during the maritime transit so that a third party Receiver acquires same rights for care/quantity of goods as original Shipper.

Thus whilst the ship is on time charter, Shipowner retains important obligations for the care and custody of goods carried on board pursuant to charterers' instructions, both to Charterer through the time charter and also directly to shipper/receiver, through the bill of lading contract.

The above services of issuing bills of lading, taking care and custody of the goods and remaining liable to shipowners and third parties for the goods carried on board, are essential services performed by Shipowner under the time charter contract.

7. The Charterer is restricted as to where he may instruct the ship to go, for example, to sail only within the geographic limits insured for by the Shipowner (Institute Warranty Limits) and to safe ports.

These restrictions demonstrate that the charterer does not have exclusive control of the right of use of the ship.

8. The Master retains the ultimate decision as to whether any sailing instruction issued by Charterer is legitimate in terms of the ship and crew's safety. The Master may decline to follow Charterer's instructions if he considers them to be unsafe for the ship. An example where the Charterers were prevented by

the Master and Shipowners from calling at their nominated ports due to safety considerations was following the catastrophic earthquake and tsunami that struck the north-east coast of Japan in March 2011. For owners with existing contractual commitments to load or discharge cargoes in Japan or for those contemplating trade to Japanese ports, one of the major concerns was the perceived potential risk to the crew, vessel and cargo of exposure to harmful levels of radiation from the Fukushima nuclear plant. Many ship operators invoked safety concerns to avoid sailing to ports in the country.

9. The safe port restriction includes the political safety of the ship, for example, the country of ship's registration may render it politically unsafe for that particular ship to call at a port in another country even though it is physically safe for the ship to call there. A charterparty is likely to contain any such restrictions on trading area.
10. The Master remains fully in control of all decisions concerning the safe operation of the ship, including routing of the ship for safety reasons, deployment of officers and crew.
11. The officers and crew operate or supervise the operation of the ship and ship's equipment.
12. The officers and crew remain the employees of Shipowner. The Charterers may not replace them.
13. Shipowner retains control of all aspects of the ship's condition and maintenance and may interrupt the time charterers' use of the services for necessary or routine maintenance purposes.
14. Shipowner retains legal responsibilities with respect to the activities of his ship and is held responsible for third party liabilities and takes out third party liability insurance for these risks.
15. Under international Conventions adopted by the International Maritime Organization (the IMO), and currently in force or about to come into force, certain liabilities are imposed mandatorily and strictly on Shipowner, and require him to take out compulsory insurance for these liabilities, even when the ship is on time charter. These include liabilities for oil pollution from ship (The Civil Liability Convention, 1969, and the Bunkers Convention, 2001), passenger liability (Athens Convention as amended by the Athens Protocol, 2002), liability for wrecks (when the Nairobi Wreck Removal Convention, 2007 comes in to force in April 2015).

All claims under these conventions are channeled to the registered Shipowner irrespective of whose fault has caused it. Shipowner is required to

obtain compulsory insurance for the risks covered by the conventions. Shipowner is strictly liable for the risks and liabilities imposed by the conventions and he is not permitted to call on defences (other than for a limited category of defences such as that the damage was caused by war, etc.). Thus Shipowner is not permitted to avoid liability by showing that the damage was due to the Charterers' fault in ordering the vessel to an unsafe port.

16. The length of the time charter period will not affect the economic and legal relationship between the Shipowner and the Charterer.

Q2 For these transactions, please specify the following:

(a) Why should this transaction not be treated as a lease and recognised by a lessee?

The time charter contract is for the provision of an all-comprehensive service utilising the asset owned, operated and controlled by shipowner and under which he retains risks and responsibilities and liabilities. Time charterer does not acquire control of the asset other than the right to direct its sailing schedule to perform his own obligations under separate contracts with shippers and to carry out his business model. The ship asset and management operations are intertwined and cannot be separated as in a bareboat charterparty contract. Thus Charterer may not have "quiet enjoyment" of the asset to use as he wishes, he has only the right to direct the vessel's sailing pattern and goods to be loaded and even this control is subject to restrictions placed on ship by shipowner such as to safe ports, within IWL, within restrictions imposed by Shipowner's insurances etc.

(b) What changes could be made to the definition and/or criteria to identify a lease, to exclude this transaction from the scope of the proposals?

The definition of lease should include requirements as to degree of control over the asset that has to be enjoyed in order to fall within the definition; it should include the concept of "quiet enjoyment" of the asset without interference from actual owner. It should contain guidance on issues of risk, responsibilities and liabilities and if all of these are transferred with the asset, there is a greater chance that it contains a lease. This is precisely the situation in a bareboat charterparty where all control, risk and liability entailed in the operation of a ship is transferred to the bareboat Charterer.

(c) How common in practice is this type of transaction?

With regard to the world tanker fleet, excluding government owned/operated and tankers owned by the oil majors, between 25-30% of the world's tanker tonnage operates on time charter basis. The information on bulk tonnage will be provided shortly when obtained from expert analysts.

Alternative approaches

Q3 Assuming that the Boards confirm the scope of application and the guidance to identify a lease, which of the approaches described above in paragraphs 14 to 21 do you prefer? Please explain the reasons for your views.

Q4 Based on the description above, which of the two approaches you believe to be less complex and costly to implement? Please explain the reasons for your views.

We again thank EFRAG for the opportunity to comment on the draft Exposure Document and would be happy to expand on any of the above.

Yours faithfully,

P. P. 

**Kiran Khosla
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International Chamber of Shipping**