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Navigating Decarbonisation Contractual and Charterparty Issues

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The next decade will see a complex and challenging regulatory framework emerge as shipping moves to decarbonise. This will undoubtedly lead to parties having to review how the costs and risks of complying with new measures should be allocated in the charterparties. This briefing is an introduction to some of the key issues for parties to consider around:

IMO CO2 / GHG Reduction Measures
CO2 Data Collection Clauses
Carbon Tax or Carbon Trading

This is a fast-developing area and we will provide further guidance as matters develop.

Want to know more?

Contact our FD&D team below, email decarbonisation@nepia.com or call **+44 191 232 5221**.



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IMO CO2/GHG Reduction Measures

The IMO at MEPC 76 in June 2021 adopted amendments to MARPOL Annex VI in respect of the Energy Efficiency Existing Ship Index (“EEXI”) and Carbon Intensity Indicator (“CII”) regulations. The amendments are expected to enter into force on 1 November 2022, with the requirements for EEXI and CII certification coming into effect from 1 January 2023. It is, therefore, important for Owners to take steps to understand what measures they will need to take to meet these new requirements and for Owners and Charterers to understand how it may impact upon the operation of the vessel.

Our article “IMO Takes First Steps to Decarbonise Shipping” summarises the EEXI and CII and can be read [here](#).

So, let’s look at what options there are available to Owners to meet the expected IMO requirements and the related charterparty considerations.

Most shipowners are expected to look to meet the EEXI requirements by limiting engine or shaft power; by installing energy saving devices; or making bow or propeller improvements. It is recommended that EEXI benchmarking is undertaken as soon as possible to enable owners to understand what modifications or changes will be required to meet the EEXI requirements. While the EEXI requirements focus on the vessel design or the technical side, the CII requirements address the reduction in emissions by operational means. A significant reduction in CO2 emissions can be achieved through operational efficiencies, whether it is speed reduction, optimisation or improving logistics. The remainder may be met by carbon capture technology or lower carbon fuels, both of which are in their infancy.

Of course, the EEXI and CII requirements have the potential to cause friction between Owners needing to meet the regulations and how Charterers want to use the vessel. However, while there will always be commercial considerations, it is hoped that Owners and Charterers will work together on this issue given that the decarbonisation of the shipping industry is important to all stakeholders.

Operational Efficiencies – voyage optimisation

Slow steaming

A time charterparty usually contains a right for the Charterer to slow steam the vessel, otherwise the ship should proceed as per the charterparty description for speed and consumption as ordered by the Charterers. It is also not unusual for the slow steaming/eco speed and consumption warranty to be given “without guarantee”, whereas the general speed and consumption will usually be given on an “about” basis.

If Owners require the option to slow steam the vessel in order to meet reductions in CO2/GHG emissions, then the Owners will want to include the right to do so in the charterparty.

Weather routing

Under the charterparty terms it is likely that the vessel will need to proceed using, for example, “utmost despatch”. There are also heights or winds. As such, Owners may wish to have the right to proceed by the most fuel-efficient route. If this is the case, an express right for Owners to do so should be included in the charterparty, which makes clear that proceeding on that basis is not a breach of Charterers’ orders and does not put Owners in breach of any utmost despatch (or similar) obligation.

Members should always consult with their usual P&I contact if they have any concern that proceeding by a particular route could be a deviation under the bills of lading.

Charterer and schedule port rotation/optimisation

If ship down time can be reduced and connectivity between ports optimised then bunker consumption (and therefore GHG emissions) may be reduced.

The IMO developed the Just In Time (JIT) arrival guide and to encourage wider adoption of the JIT arrival principles BIMCO has now developed a new clause for voyage charter parties, with Steven Cockburn, Deputy Global Director (FD&D) of North on the drafting committee. The clause creates a contractual framework to overcome the primary obstacle to just in time arrivals, which is the obligation on shipowners to proceed with due or utmost despatch and without deviation. This is a critical aspect of making JIT arrivals work. Without removing this obstacle ships are unable to adjust their speed to arrive at a port at an optimal time to avoid delays without breaching their usual voyage charter obligations. BIMCO believes that the widespread adoption of JIT arrivals in the bulk sector will bring many benefits including reductions in fuel consumption, emissions and waiting times in likely to be obligations under the bills of lading not to deviate. There may be a failure to prosecute the voyage with utmost despatch where, without good reason, the master sails at reduced speed, or takes a route other than the shortest and the quickest. However, in some cases it may be that the shortest route between two points will not be the most fuel efficient because of currents, wave ports and anchorages.

A copy of the clause is on the BIMCO website : **Just in Time Arrival Clause for Voyage Charter Parties 2021** ([bimco.org](https://www.bimco.org))

The above clause may also be used together with the BIMCO Port Call Data Exchange Clause 2021. This latter clause has been designed to encourage wider application and use of the IMO data model framework for the harmonised exchange of ship/port information.

From a time charterer's perspective, as well as including the Port Call Data Exchange Clause, it may be wise to ensure there is a right to slow steam for Charterers in the charterparty.

Reduction of cargo intake

The CII (Carbon Intensity Indicator) calculation does not consider the mass of the actual cargo carried on a voyage. The ship's capacity will be the deadweight tonnage (DWT) for most cargo carrying vessels. However, the gross tonnage (GT) is likely to be used for other vessel types. This means that a vessel's CII rating will not be impacted by how much cargo the vessel carries during the period under review. For example, a container vessel that operates fully loaded would not benefit over one that is usually partially laden; in fact - it may be at a disadvantage because the extra fuel consumption from being fully laden leads to CO₂ emissions and therefore a poorer CII rating.

It's important to note that in-ballast passages will not have a negative impact on the vessel's rating.

Shipowners and operators should be aware that some of the other initiatives that require the reporting and/or calculation of carbon emissions take a different approach to 'transport work'. For example, the Sea Cargo Charter calculation considers actual cargo carried rather than deadweight, and the EU MRV requires the vessel to report actual cargo carried, which may also impact upon the calculation for the EU ETS.

Particular attention will need to be given to the wording of charter party clauses both for existing and new charters. If Owners choose to reduce cargo intake in order to consume less fuel and, therefore, reduce the risk of a poorer CII rating, this could put Owners in breach of any cargo capacity warranty included in the charterparty, as well as potentially breaching other clauses such as those relating to following Charterers' orders and allowing Charterers the whole reach of the vessel's holds and cargo spaces. Further, as noted above, given other initiatives do take into account actual cargo carried and so reducing cargo intake may not be preferable as regard such other initiatives/regulations, it may be preferable to provide for operational efficiencies in the charter party drafting other than reduction in cargo intake.

Vessel modification - emerging technologies

Some of the emerging technologies to reduce CO₂/GHG emissions require modifications to the vessel itself, for example installation of

energy saving devices, such as duct and fin technology.

If Owners intend to meet the IMO measures/IMO targets by installing energy saving devices on their vessel(s), the cost of installation will be for Owners' account, unless it is agreed with Charterers that they will contribute to the cost, for example either to the direct cost or by increased hire rate, given the devices should ultimately create bunker savings for a time charterer.

The time for installation of such devices and/or a provision allowing the vessel to deviate to dry dock for such installation etc, should be considered for inclusion into any relevant charter. Provisions dealing with the maintenance / breakdown / repairs of such devices may also be needed.

Where the engine or shaft power is to be limited Owners will want a right to amend the vessel description accordingly, as well as any other charter party terms that are affected, such as speed and consumption warranties for example.

The case of *The Elli* and the *Frixos* considered a claim relating to the new MARPOL regulations which came into force in 2005 making it unlawful for any ship to carry fuel oil as cargo unless it was either double-hulled or double-sided. Expensive modifications were required to the ships in question to enable them to comply with these new regulations. The Court found that the Owners were in breach of certain clauses in the particular charterparties for not. Some charterparties include clauses that require Owners and Charterers to discuss and agree how to deal with regulatory changes, which require modifications to vessels. However, such clauses do not usually clearly define each party's responsibility beyond that having carried out the necessary modifications, namely a breach of warranty that the vessel would be legally fit to carry the permitted cargo and a breach of the Owners' due diligence obligations to remedy the deficient condition of the vessel.

However, the fact that the vessel must be legally fit does not mean an Owner has an obligation to upgrade a vessel so that Charterers' operations are more economic. A particular vessel modification, which could allow an Owner to meet the EEXI/CII requirements, is likely to be only one of the options available to an Owner to meet the requirements and, therefore, the situation in *The Elli* and the *Frixos* is unlikely to arise.

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Alternative fuels

Many of the alternative fuels being talked about as the fuels of the future are very much in their infancy. However, there are some

alternative fuels available, which should reduce GHG emissions. At this point, it is also worth bearing in mind the difference between a reduction in emissions well to wake (whole process) and a reduction in emissions tank to wake (from when the fuel hits the tank to when propulsion produces a wake). On a tank to wake basis, biofuels compare to fossil fuels, however, if you look at the well to wake emissions, biofuels may be a better, more sustainable option. We do not yet know whether the IMO measures will support the well to wake approach.

Biofuels

Biofuels can be blended with traditional crude-derived marine fuel oils or used as a "drop-in" fuel, where they act as a direct substitute.

There are numerous biofuels, all derived from various feedstocks through different processes.

Whether Owners and Charterers are considering a trial of biofuels, or whether biofuels are to be used as the vessel's fuel, the following points are important to consider from a charterparty perspective.

- Will the trial/use of biofuels start under an existing long-term time charter, or will there be a new charterparty put in place before the trial/use of biofuel takes place?
- All clauses relating to bunkers will need to be considered, such as bunker quality/specification clauses, as well as bunker price and BOD/BOR clauses.
- What specification applies to the biofuels? There is no standard specification for biofuels. ISO 8217 is a fossil fuel standard and whilst it could be used for guidelines there are missing parameters relevant to biofuels and others which are no longer relevant. From a charterparty perspective, if biofuels are to be used then wording could be included, for example, that Charterers are to provide biofuels of a quality and specification which are approved by the engine manufacturer. A requirement in the charterparty for Charterers to provide the certificate of quality could also be included. Some engine makers have already carried out testing of certain biofuels to check the compatibility with their engines. In terms of the quality of the biofuel the biggest concern given that there is no standard specification is that some suppliers may provide poor quality biofuel.
- Consideration should be given to the performance warranty. Biofuels use a bit more fuel than fossil fuels for the same propulsion.
- Potential inclusion of a tank cleaning clause and consideration of the maintenance clauses and dry dock clause. Cleaning of tanks from previous fuels may be prudent to prevent compatibility problems and if there are any quality concerns it's easier to prove when a clean tank has been used at the outset. Dry docking should not be necessary prior to any trial/use of biofuels as they can often be used with no or minimal modification to the vessel.

However, it may be prudent in any event for an Owners to have the right to dry dock other than just in the case of an emergency or for the scheduled dry dock.

- What will happen in the event of time loss/costs being incurred as a result of a biofuel trial?
- Consideration of whether alternative fuels need to be provided in the event of non-availability of the agreed biofuel.

LNG

As mentioned on our **2030 Targets page** DNV strongly predict LNG will be the transition fuel of choice. From a charterparty perspective the following points will need to be considered.

- Will LNG bunkering operations interfere with cargo operations? If so, at whose cost?
- Consideration of the fact that bunkering infrastructure for LNG is more limited than fuel oil/diesel oil for example.
- All clauses relating to fuel will need to be carefully considered in view of the special characteristics of LNG and the lack of standard specifications. There is currently no standard specification for LNG bunkers. The quality requirements for LNG bunkers will be given by the engine manufacturer (e.g. minimum methane no., lower heating value, maximum amount of hydrocarbons other than methane and limits on trace components). However, these parameters cannot be too narrow as LNG composition varies quite significantly around the world.
- It will also be necessary to consider different sampling methods. LNG samples have to be taken through a dedicated sampling unit and are usually taken from the supply manifold, not the vessel manifold, whereas standard bunker clauses usually provide for samples to be taken from the vessel's manifold. Clauses will therefore need to be tailored to deal with this.
- Will the use of LNG affect the speed and consumption warranties? Owners need to be mindful of the equivalent calorific benefits of fuel oils versus LNG, as well as the different calorific value between different LNGs. For example, LNG with a high methane content might have a lower calorific value than LNG with a lower methane content. This means more fuel is consumed to achieve comparable power output. The potential for variations in performance must be taken into account when agreeing any vessel performance warranties.
- Will an indemnity from the Charterers be required to cover onerous Conditions of Use terms for LNG bunkering operations? If Members are concerned by any onerous terms in the LNG bunker delivery contracts, they should consult with the Club in case they may impact P&I cover.
- Are there any standard LNG bunker clauses? Yes, Intertanko published the LNG Bunkering Clause for Time Charterparties in January 2021. The commentary on this clause can be found here: **Model Clauses Library - INTERTANKO**.

CO2 Data Collection Clauses

On our [Industry Initiatives page](#) we highlighted The Sea Cargo Charter (SCC), which provides a framework that enables shipowners, charterers and cargo owners to align their activities and promote shipping's green transition.



Where Charterers have signed up to the SCC, a suitable clause will be required in the charterparty to ensure that Owners/Operators are compelled to provide the requested data and information.

The SCC has a bespoke clause, which they say is designed to be generic and broad in nature so it can be used with any charterparty form. The SCC also says it is non-prescriptive to resist the urge for parties to make amendments. The SCC clause can be found at the following link.

[Sea-Cargo-Charter-Clause.pdf](#)

As you will see, the clause requires Owners/disponent Owners to submit a completed emissions form, in the format required by the Clause, within 7 days of the completed voyage. Owners/disponent Owners may want to assist with shipping's decarbonisation goals and so it is expected that the clause may be included unamended. However, should Members have any questions around the clause, or have concerns about any responsibility or liability for errors or omissions in the information provided under the Clause then please do get in touch with your usual Club contact, or one of our Navigating Decarbonisation experts.

Outside of the Sea Cargo Charter, there are Charterers taking the initiative themselves to collect GHG emissions data. Therefore, we have had questions come in from Members regarding bespoke CO2 data collection clauses that have been presented to them by Charterers for inclusion in their charterparties. It is expected that we will see more and more of such clauses as time passes towards the decarbonisation goals.

There is no obligation on the Owners to agree to such clauses in their charterparties and so it is a commercial decision. However, as with the Sea Cargo Charter, it is expected that Owners may want to assist with the decarbonisation goals and so will agree to such clauses, so long as it does not impose any onerous obligations or liabilities on them.

Of course, it will be important for Owners to review the wording of the requested clause and the following points are worth bearing in mind:

- Are Owners being asked to provide information which could be an onerous task, as opposed to information that is readily available?
- Is there wording in the clause that could allow the Charterers to request changes to the information provided/format the information is provided in?
- Is the time frame within which Owners are being asked to provide the requested information reasonable/achievable?
- Is it clear within the clause who Owners are to send the information to?
- Are Owners being asked to make a monetary contribution towards Charterers' CO2 data collection program? If so, is this acceptable to Owners or not?
- Have Charterers provided details about who will use the information provided and where it will end up?

Carbon Tax or Carbon Trading

Emission Trading System (EU ETS)

On 14 July 2021 the European Commission adopted a package of proposals, which included bringing shipping into the EU ETS from 2023. Under the proposal, shipping will be added to the EU ETS on a gradual basis from 2023, when shipowners must surrender enough EUA to cover 20% of their emissions. This is expected to rise to 45% in 2024 and 70% in 2025. From 2026, shipowners will need to surrender EUA to cover 100% of their emissions under the scheme.

It is a system whereby a cap is set on a company's permitted emissions, and spare emissions may be traded. If, however, a company produces emissions in excess of its permitted cap then large fines are imposed and, in the event of failure to surrender sufficient allowances for two or more consecutive periods, potential expulsion from EU ports. The idea is that the cap on emissions is reduced over time as companies should be decarbonising. It is expected that 50% of revenue generated by shipping being included in the EU ETS will go towards a Maritime Decarbonisation Fund.

It is understood that it will likely apply to ships over 5000 GT and in respect of emissions from ships performing voyages with the purpose of transporting passengers or cargo for commercial purposes (and therefore includes ballast voyages as well). It includes all emissions from intra-EU voyages, all emissions occurring while a vessel is at berth in an EU port, 50% of emissions from a vessel's incoming voyage to an EU port from a 3rd country port and 50% of emissions from a vessel's outgoing voyage from an EU port to its next 3rd country.

Compliance with the EU ETS will, in the first instance, be the responsibility of the 'shipping company', which the EU defines as "the shipowner or any other organisation or person, such as the manager or bareboat charterer, that has assumed the responsibility for the operation of the ship from the shipowner" in accordance with the ISM Code. However, given that it will be due to the charterer's trade of the vessel that will result in the shipowner's liability under the EU ETS, inclusion of a suitable clause in the charter party will be necessary to pass the liability down to charterers. If shipowners wish to pass the liability down per voyage, rather than claiming at the time their liability has been verified and becomes due under the EU ETS (by latest April of the following year), while the emissions can be calculated by reference to the EU-MRV emission equation, a mechanism will need to be included in the charter party clause to ascertain the EUA price at the relevant time.

International Carbon tax or carbon-based pricing for marine fuels

At present there is no concrete proposal for either an international carbon tax, or for carbon-based pricing for marine fuels. However, as with the EU ETS above, if an international carbon tax was to be imposed then similar charterparty considerations would be relevant and a clause should be included to deal with the ultimate liability.

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