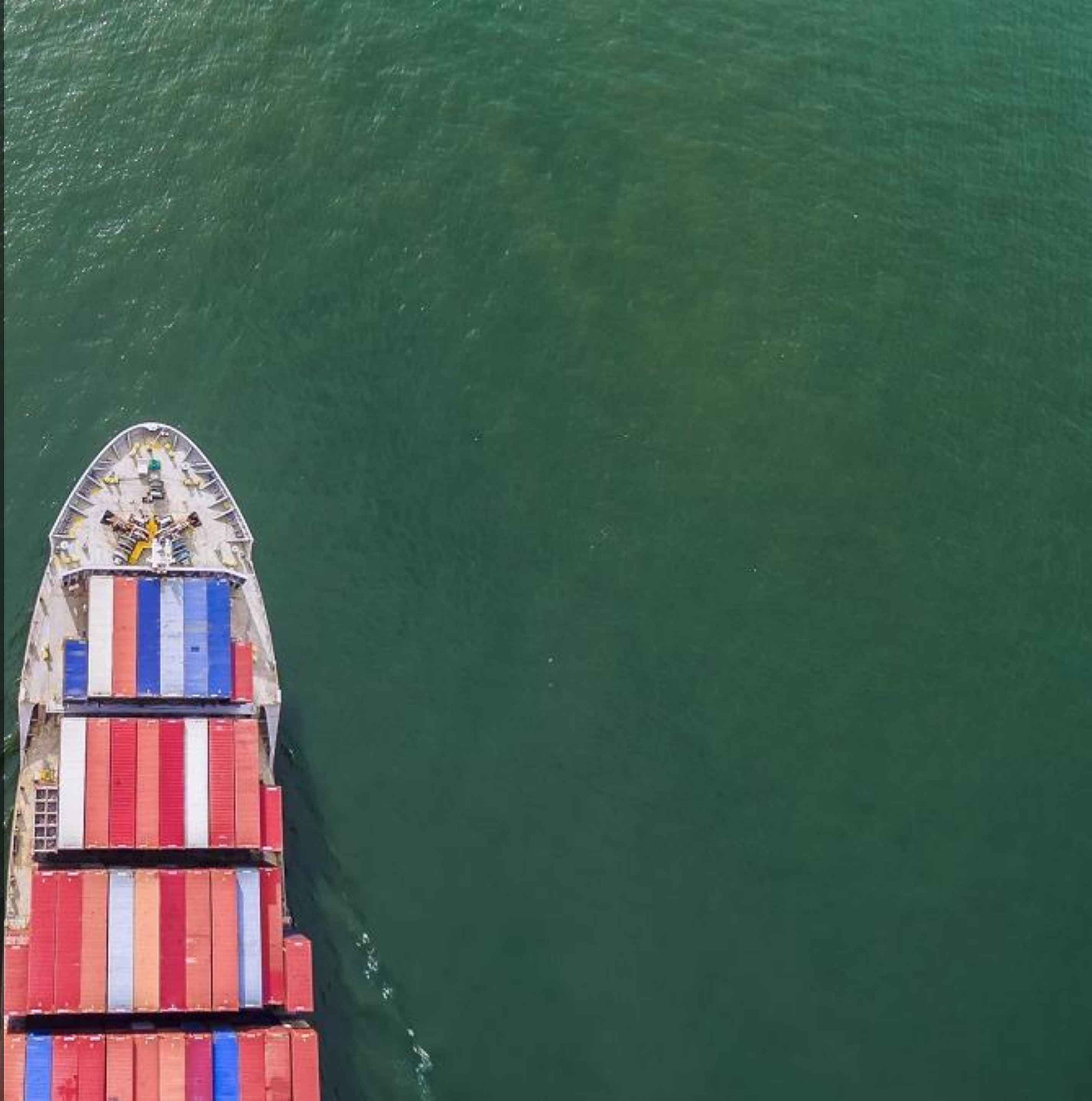
Achieving Decarbonisation Through Shipping Contracts

Dr Pia Rebelo

City Law School, City, University of London

Introduction: Net Zero

1. Regulatory Developments on Decarbonisation
2. Justification for a Contract Governance Approach
3. Traditional Maritime Contracts & standard compliance clauses
4. Contractual Tools for Net Zero



IMO Roadmap

- MEPC 72 (2018): First Initial Strategy
- Identified "levels of ambition": *reduction in total GHG emissions from international shipping which should peak as soon as possible and to reduce the total annual GHG emissions by at least 50% by 2050 compared to 2008, while, at the same time, pursuing efforts towards phasing them out entirely.*
- Pathway includes candidate short-, mid- and long-term further measures with possible timelines and their impacts on States.
- MEPC 76 (June 2021) approved the Work Plan to Progress development of mid- and long-term GHG reduction measures.
- ISWG-GHG 12 (2022): "basket of measures" including carbon pricing, fuel options, operational measures

IMO Regulatory Action

At MEPC 76 in June of 2021, the MEPC adopted amendments to MARPOL Annex VI, introducing mandatory goal-based technical and operational measures to reduce carbon intensity of international shipping.

- The Energy Efficiency Existing Ship Index (EEXI)
- Carbon Intensity Indicator (CII) rating scheme
- Enhanced Ship Energy Efficiency Management Plan (SEEMP)

taking effect from 1 January 2023.

EU: Existing Regulations

1) The Alternative Fuels Infrastructure Directive ('AFID', 2014/94/EU)

- LNG for ships
- shore-side electricity supply

2) Regulation on the monitoring, reporting and verification of CO_2 emissions from maritime transport ('EU MRV', Regulation 2015/757/EU)

3) Directive on a reduction in the sulphur content of certain liquid fuels (2016/802/EU)

4) The recast Renewable Energy Directive ('RED', 2018/2001/EU)

EU Fit for 55

- A revised EU emissions trading system directive (EU-ETS, COM(2021) 551) aims to involve shipping in EU carbon trading.
- FuelEU Maritime – a new regulation on sustainable maritime fuels that seeks to drive the shift towards low carbon maritime fuels.
- A revised directive on alternative fuels infrastructure
- A revised directive on energy taxation (COM(2021) 563): aims to end the tax exemptions for conventional marine fuels and incentivise the uptake of alternatives.
- A revised renewable energy directive (RED II, COM(2021) 557): new EU economy-wide target of an at least 40 % share of energy from renewable sources in 2030; new renewables target of GHG intensity reduction of at least 13 % by 2030 in the transport sector.

Will Regulation be Enough?

- IMO is stalling on its package of measures
- EU is taking unilateral action when industry prefers uniform standards
- EU measures will only apply to vessels registered in Member States or Calling at EU Ports (pushing the problem elsewhere?)
- Will we ever have a set of global measures?
- Pluralistic forms of governance?

Contract Governance:

- Enrolment of Private Actors: *Concept of a Sustainable Maritime Transport System* (Symposium on Sustainable Maritime Transportation System, World Maritime Day on 26 September 2013)
- Contemplates a wide range of rule and decision makers.
- Considers 'interplay between external and internal impacts on decision-making in institutions (state or corporation) and the analysis of 'weak spots' within a scheme of collaboration' (Grundmann et al).
- Comprises both traditional and progressive assertions that contracts *govern*, and that we are also concerned with the *governance* of contracts.

Contract Governance:

Incorporates theories of ‘corporate governance’ and ‘private authority’, which have for a long time recognised reflexive governance mechanisms, including ‘regulated self-regulation’ and ways of connecting the corporate world and state-centric world.

Considers:

1. Contract and third parties
2. Contracts and networks
3. Contract and organisation

Traditional Maritime Contracts

- Do not employ theories of contract governance for sustainability issues.
- Incorporate traditional views of laissez-faire capitalism.
- Guiding values confined to freedom of contract and commercial efficacy.
- Environmental and sustainability considerations confined to cost and risk allocations more mere regulatory compliance.

Haris Zografakis (2021) on decarbonisation in shipping:

- Maritime contracts have developed sophisticated (the uninitiated would say arcane) mechanisms for allocating the financial cost of operational inefficiencies to shipowners or charterers (or buyers or sellers of cargo): demurrage, laycan, “utmost dispatch”, speed warranties, ballast voyages, off-hire…
- Quotes Martin Stopford that the shipping industry *“… operates within a strict economic regime, which would be immediately recognizable by 19th century classical economists. It is, more or less, the “perfect” market place at work, an economic Jurassic Park where the dinosaurs or classical economics roam free …”*.

The proposed standardized clauses to deal with decarbonization reflect this.

BIMCO's EEXI Transition clause for time charterparties (2021)

a. Any modifications to the vessel for the owner's account (EPL or SHAPOLI)
b. Makes provision for 2 types of engine modifications

BIMCO's Emission Allowance Clause (2022)

a. Simply treats the transfer of allowances from charterer to owner very much in the same way as payment of hire

Problems with traditional contracts:

- Do not overcome the problem of split incentives.
- Provide no cooperative normative framework.
- No scope for interpretations other than those that are most cost effective. This causes problems with:

1. Fuel/Technology selection
2. Slow steaming
3. Even deters regulatory compliance (Norway – "duty of loyalty" in marine insurance contracts).

Why would private actors want to achieve more than compliance?

- Not only regulatory pressure
- ESG: reputational risk, litigation risk (“greenwashing”)
- Green finance frameworks: “knock on effects”
- Voluntary frameworks: Poseidon Principles, Sea Cargo Charter
- Long term market resilience
- Consumer demand (not yet as big a pressure)

What can contracts do:

- Better alignment with the Climate Change Agenda
- Climate clauses can provide mechanisms for ambitious decarbonization commitments.
- Implement Green interpretive norms: The “Law of Standard Agreements”: Standard form agreements are, ‘generally speaking, the most important instrument nowadays for norm creation in business’ (Ulf Bernitz, ‘Commercial Norms and Soft Law’ (2013) 58 Scandinavian Studies in Law 29-43).

The Chancery Lane Project

Climate Clauses for Shipping

Fuel Reporting Clause for Shipping Charterparties

Aiden's Clause

A clause to be inserted as a rider to time and/ or voyage charterparties combining 'green' fuel use, reporting and disclosure obligations with a levy for using fuels with a higher carbon content.

Energy Efficiency in Shipping

Otto's Clause

A contractual duty in charterparties for both parties (charterers and owners) to take all reasonable steps to maximise energy efficiency.

Maximising the Laden Ratio of Vessels in Shipping Charterparties

Bradleigh's Clause

A charterparty clause encouraging the parties to consider opportunities and cooperate to maximise the laden ratio of the vessel and minimise repositioning voyages in ballast during the charter period.

Incentivising Fuel Efficiency Investments In Time Chartered Vessels

Ariel's Clause

An optional mechanism for time charterparties, to share the cost (between owners and charterers) of upgrades which improve the fuel efficiency of time chartered vessels.

What mechanisms do these Climate Clauses employ?

- Recitals/Preambles – cooperative normative framework for interpretation.
- Realise the goals of green finance frameworks
- Energy Efficiency as a Negotiated Term in Chartering – overcoming split incentives
- Third party management: bunker supply; monitoring systems, manufacturer faults

Recitals/Preambles

- Recitals or ‘background provisions’ illustrate the commercial context of an agreement and assist with the reading and interpretation of contractual obligations therein.
- TCLP provides Eddie’s Recital: to ‘frame a contract and the intentions of the parties in terms that are aligned with achieving net zero or net negative emissions and Paris Agreement goals’.
- *Blackpool FC (Properties) Ltd. v JSC Baltic International Bank* [2018] EWCA Civ 732: provides evidence of the ‘factual matrix’ of the contract.
- **Preamble of the RECYCLECON**: parties have agreed to buy/sell vessel has agreed to buy the Vessel on ‘the following terms and conditions which, in particular, include an undertaking to recycle the Vessel in a safe and environmentally sound manner consistent with international and national law and relevant guidelines.

Realising the impacts of Green Finance Frameworks

DIRECT:

Design specifications in shipbuilding and manufacturing contracts

How the vessel operates: chartering arrangements, fuel supply, tail-end emissions

INDIRECT IMPLICATIONS:

Supply chain: sourcing of materials and supplier's green credentials

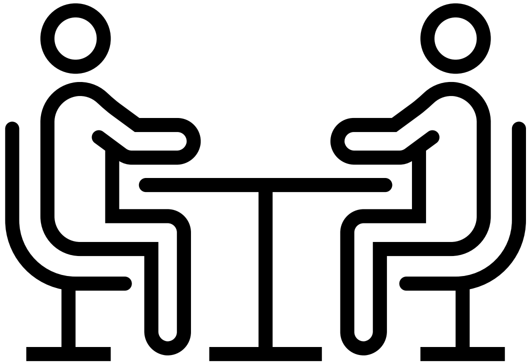
How the vessel is to be dismantled and recycled at the end of its life (green passports)

Voluntary Frameworks:

- Loan Market Association's Green Loan Principles and the Sustainability Linked Loan Principles
- Common Principles for Climate Change Adaptation Finance Tracking (less relevant to shipping, more focused on urban transport)
- International Capital Market Association (ICMA): Green Bond Principles - Clean Transportation activities are directed by an 'Avoid-Shift-Improve (ASI)' method
- Climate Bonds Initiative (CBI) certification standard: The Shipping Criteria
- Poseidon Principles: Not a taxonomy initiative, but uses a carbon efficiency metric

Energy Efficiency as a Negotiated Term in Charterparties

- Overcomes **Split Incentives**
- Aims to achieve the **optimum reward** for energy efficiency which determines a fair payment and resolves the level of contribution between the contracting parties.
- **Why not just have a higher freight rate for "green" vessels?** Overcomes issues surrounding **performance warranties.** *The C Challenger* [2020] EWHC 3448 (Comm).



Ariel's Clause: *If Costs-Sharing was accepted by the Charterer pursuant to clause [1.3], at redelivery of the Vessel, the Charterer shall pay to the Owner [[●]% of the market value of the volume of fuel saved as a result of each Energy Saving Device installed with the Charterer's prior written agreement to Costs-Sharing pursuant to clause [1.3] above] [OR] [an increased freight rate/ daily hire rate of [$][●]].*

Third Party Management:

Lessons learnt from bunker supply issues: Houston problem (off spec fuels)

Parties may want to take a supply management approach:

- Approved supplier lists for bunkers/manufacturers/monitoring systems (those with green labels; FuelEUMaritime)
- Depends on bargaining power of suppliers, but parties could pass down the risk of non-compliance or climate risks
- Cooperative clauses for greenest fuel available

Aiden's Clause: *During the performance of this charter owners and charterers shall use [[best/ reasonable] endeavours to] [cooperate with a view to using]* bunker fuel with the lowest available CO2 Emissions Factor compliant with the Vessel's bunkering infrastructure and operational requirements.***

Outcomes for Maritime Contracts:

- More readily adapt to compliance risks
- Achieve greater ambition than regulatory standards and targets
- Realise more ambitious voluntary commitments to net zero
- Hardening of soft norms
- Much of English contract law has evolved out of maritime disputes: elevation of green interpretive norms
- Normative effect can extend to other contractual settings: supply chain managment