

CHARTERPARTY ISSUES AND OBSERVATIONS

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Charterparty Issues and Observations

1. Although obvious, it is worth differentiating between Time Charter Contracts and Voyage Charter/Contracts of Affreightment as the operational decisions taken under each of these two distinct contract forms vary as to where responsibility for potential carbon reducing actions lie.

2. Dealing with the first of these two types of contracts – namely **Time Charters**

- a. **Issue:** The decisions effecting the carbon intensity index or Energy Efficiency Operating Index (EEOI) are all within the Charterers purview, yet the resulting impact of the results of these decisions must be borne by the Owners under the current approach being promoted by the IMO and other international bodies. This seems fundamentally unfair. While associations such as the Sea Cargo Charter initiative are trying to cause the transparent disclosure of the effective EEOI results on their own account, this does not mitigate the fact that the Owners vessel performance and disclosed measurement of carbon intensity is determined almost exclusively by the decisions taken by the Charterer.

Note: The Owner is fundamentally responsible for the Energy Efficiency Design Index (EEXI) which is a measure of the design specification of his vessel – a measure that can be influenced by decisions taken by the Owner when building or modifying a vessel irrespective of the future operational use of the vessel. Once on time charter, the speed, routing, cargo load quantities, distance of voyage and other factors such as port congestion and load/discharge parameters are all controlled by the Charterer, and it is all these factors that contribute to the calculation of the vessel's EEOI]

- i. **Question:** What can be done to alter this “unfair” equation so that the Owner is not adversely affected by the EEOI as calculated when on time charter vs the actual carbon emissions impact that would have been measured at optimized operational conditions using EEXI?
- b. **Issue:** While Owners may have the ability to make investments in their existing vessels to effect improved fuel efficiencies and by extension reduce the gross carbon emission quantities through an improvement in the Vessel's EEXI, there is neither an existing methodology to measure or monetize the value of the reduced carbon emissions, nor, in practical terms, is there a viable means of capturing the value of the reduced fuel consumption as the competitive nature of the chartering market rarely differentiates – in time charter negotiations – on a systematic basis, marginal fuel consumption differentials between vessels of the same type/class. The upshot: there is little to no incentive for owners to invest in fuel efficiency initiatives as there is no clear means to recover the necessary upfront investment through a demonstrable and visible improved cashflow to be obtained following the implementation of any such improvement.

- i. **Question:** What can be done to create a more transparent and effective way to allow Owners to take decisions to invest in efficiency improvements (i.e. to improve the EEXI of its vessels) so that there is a visible and demonstrable return to the owner on making such an investment. Note that the investment recovery period may require a number of years to be sensible but that many if not most current time charter periods are of relatively short duration – e.g. one year or less. This demands an approach that would enlist the support and agreement of the large majority of Charterers recognizing that it is most likely that the vessel will be chartered by different parties over the assumed investment cost recovery period.
 - ii. **Question:** What can be done to allow the carbon emission reductions achieved through improved fuel consumption resulting from investments by the Owner in improving the EEXI of its vessels to be monetized? If monetization of the CO₂ emission reductions can be monetized, what is the best approach to sharing the value of this as between Charterers and Owners?
- c. **Issue:** Current commercial practice makes the accurate and transparent disclosure of real speed and consumption figures difficult to obtain and/or assess. Charter party terms provide, in most cases, for warranted speed and consumption figures at a specific speed under specific conditions – i.e. under certain weather conditions, on even keel, excluding transit of congested areas, etc – and do not provide a full range of speed and related consumption across a range of operational conditions. This affords owners shipboard personnel the opportunity to “manage” consumption figures to meet charter party requirements with daily fuel consumptions not always being reported in an accurate manner, but rather with a view to complying with CP warranties. Consumptions can be inflated when the vessel is operating outside of warranted speed and or weather acceptable ranges, so as to create “pocket bunkers” to be drawn on during operational periods within operational ranges. Further, when competing for a charter, Owners may understate actual speed and consumption figures in CP terms in order to obtain a business and then manage the actual consumption results as above to attain compliance with the CP terms. While over the course of a longer charter, these differences tend to balance out, the data discrepancies latent in these practices present reporting and disclosure issues.
 - i. **Question:** Given the long-standing practices in the industry of managing speed and consumption figures as a commercial variable in a competitive environment, shouldn’t the focus be on actual emissions rather than deriving emissions from fuel consumption figures? Are there in existence data gathering devices that would provide for “radical transparency” of actual emissions through a direct, rather than indirect means? How would incentives be created to adopt the use of such devices if available?

3. Dealing with the second of the two types of contracts – **Voyage Charters (and by extension Contracts of Affreightment)**:
- a. **Issue:** While the operational decisions effecting the carbon intensity index or Energy Efficiency Operating Index (EEOI) are, in a voyage charter contract, theoretically within the Owners purview, the commercial returns of running a shorter and thus more “efficient” voyage vs a longer and – in EEOI terms, less efficient voyage do not currently offer incentive for electing to perform the former over the latter voyage. [For tankers] In *Worldscale Terms*, the daily time charter equivalent of the two voyages should calculate out to the same. As such, in most cases, the owner will likely, in a flat to falling market, opt for the longer voyage as gross economic return will be higher for longer vs shorter voyages. Again, an EEOI measurement doesn’t seem to make sense since, one voyage of 30 days and 2 shorter voyages of 15 days will produce the same amount of raw emissions. But, the EEOI in the former case will be 2x that of the later one. While the approach of EEOI over time may create sufficient disincentive for the owner to opt for the longer voyage, it seems unfair to penalize the owner for supply and distribution decisions that are fundamentally being taken by Refiner/Distributor customers. Again, the *Sea Cargo Charter* disclosure requirements might offer some redress to this asymmetrical equation, but this would only be the case if there were widespread adoption of the *Sea Cargo Charter* reporting requirements by all major shippers involved in decisions as to where to obtain product and to where to ship it.
 - i. **Question:** Why should the owner be asked to bear the “cost” of decisions made as to where product demand in a particular market is sourced? In theory, [for tankers] *Worldscale Rates* could be adjusted to provide an additional cost for low efficiency voyages creating an incentive to source product from nearer supply points to improve the EEOI outcomes. Higher flat rates would also improve the returns to Owners providing a monetary offset to the lower EEOI score. Is this a viable approach thinking about this proble
 - b. **Issue:** The commercial math of existing lay-time and demurrage provisions in voyage charterers rarely – if ever – offers any incentive for the Owner to any do anything other than to proceed at the fastest possible speed without regard to fuel consumption or emissions impact. This is because (a) especially in a *Jones Act* context, the value of time far exceeds the value of extra bunkers consumed; and (b) there is no current direct cost for increased emissions produced, or benefit for notional emissions saved by running at a slower speed. Lay-time and demurrage do not count until/unless NOR at load or discharge port is tendered. In many cases, port congestion results in vessels incentivized to “hurry up and wait” since time lost to slower speeds is not compensated. Clearly refusing to compensate owners for the benefits of “just in time arrival” (lower fuel consumption in transit/ lower in port emissions) is a considerable obstacle in current charter party provisions to meeting emission reduction goals.

- i. **Question:** Is there a viable means to alter the economics of current lay-time and demurrage provisions which are keyed off of actual NOR times to try and work towards a more optimized “just in time” arrival approach? The container industry already applies “just in time principles” in many ports (largely because the liner operators mostly time charter ships and the terminals are under their control). So, there may be lessons to be learned from what the container industry is doing in this regard with a view towards creating a “virtual NOR” time for determining lay-time and demurrage calculations. Again, “radical transparency” is likely a precondition to success in instituting virtual NOR provisions given the need to ascertain the validity of projected arrival times based on weather, current, speed and other factors affecting arrival times, as well as determining actual amounts of fuel conserved/emissions avoided by slowing a vessel down in response to port congestion up ahead. Are there other means of creating the right economic balance to compensate owners for demurrage lost by proceeding at a slower speed?
- c. **Issue:** Data collection regimes such as the Sea Cargo Charter are imposing additional reporting requirements on owners at the behest of their charterer customers. Owners already bear a large administrative burden and cost in both gathering, and in many cases obtaining independent verification, of data requested. Charterers in some cases are trying to pass the costs of their own disclosure objectives down the line to Owners – again a seemingly unfair approach to what is a communal problem. See, for example, CP terms introduced by Vitol which “will be a requirement for all future voyage contracts”

#1: New Charter Party Main Term

CO₂ Data Collection Clause - SIGLAR

Charterers collect CO₂ emission data from shipping activities and Owners are therefore required to report daily position and bunker consumption throughout the entire voyage. Please forward following to co2.vitol@siglarcarbon.com

1. A list of daily bunker ROB and consumption figures for ballast leg (starting at COSP discharge port on previous voyage until current day)
2. Noon reports which include bunker ROB and consumption figures for the remaining voyage.
3. Bunker ROB and consumption figures at EOSP and COSP each port.

Owners will be contacted if any additional information is needed and with regards to any format in which the information is required to be provided. Owners agree to offer all reasonable assistance to Siglar to enable them to collect and report data relevant to CO₂ emissions in connection with this charterparty. Owners' contribution to the cost of collecting, verifying and reporting emissions data arising under this charterparty is USD 250, which shall be deducted from freight (Owners to adjust their freight invoices accordingly). Charterers will arrange remittance of Owners' contribution to Siglar, direct. If you have any questions regarding CO₂ emission reporting or wish to obtain a copy of the CO₂ emission report for this charterparty, please contact co2.vitol@siglarcarbon.com or call +4790642020

This type of data collection (consistent with what is being sought under the Sea Cargo Charter provisions) is in addition to what Owners are already reporting under various regimes and is essentially for the benefit of the Charterers to allow them to develop and communicate their own Carbon Reporting Regime. While laudable as a goal, it is not clear to OSG, as an Owner, why the owner should be asked to bear the cost of this data collection and analysis. We have been informed that this clause will feature in all future charters with Vitol – and is typical of what we see in terms of certain Charterers looking to make a profit center out of what is supposed to be an act of good corporate citizenship.

- a. **Question:** Should charter party terms deal with the data collection process in a standardized manner so as to allocate fairly the costs and benefits of collecting and providing this data for the benefit of the greater good? If so, how can this be done?