The Swedish Club

Use of tankers as floating storage – arising legal issues

At a Glance

In recent years, international oil markets have witnessed collapsing oil prices as a result of an excess in supply and a corresponding decrease in demand as consumer behaviour switches slowly away from a dependency on oil. Oil refineries and storage facilities are near or at capacity. The absence of terminal and tank farm capacity has generated renewed global interest in and a growing demand for oil tankers to be used as floating storage. This increase in demand for floating storage is being reflected in daily hire rates, with VLCC rates being pushed from averages closer to $100,000 to reportedly in excess of $300,000 a day, according to industry sources.

While no doubt compounded by the COVID-19 outbreak and the resultant uncertainties it has generated for international trade, the current macroeconomic climate means that there will be potentially very long periods during which tankers will be used as floating storage. Given that most charterparties do not contain storage clauses, or have clauses which are legally or practically deficient when considering long-term storage, owners and charterers alike are presented with an array of issues that need to be carefully considered and the risk allocated to avoid legally significant and potentially expensive consequences. Any failure to do so may result in legal implications which could be far-reaching.

This briefing note will discuss a number of legal issues that may arise under a charterparty or bill of lading contract, where owners accept charterers' requests to employ their tankers as floating storage. The discussion is intended to highlight the various issues. The terms of individual charterparties, together with the factual circumstances, will determine the scope of consideration required in each case.

Time charterparties

Within the contractual and legal limits of the charterparty, charterers enjoy wide liberty to employ a vessel to accommodate their commercial requirements. This will usually take the form of voyage orders for the vessel to proceed from one named port to another, to carry one or more named cargoes, and may include waiting time at named ports or places. The principal restrictions on charterers are generally the requirement to nominate safe ports or berths, the range of cargoes permitted to be carried, compliance with Institute Warranty Limits, and any sanctions compliance.

However, when a charterer orders a vessel to be used as floating storage, the position is not as straightforward as an order to proceed from one named port to another for the purposes of loading and discharging. For charterparties that contain a floating storage clause, such as BPTIME 3 (clause 21 – Storage), a right to order a vessel to be used for floating storage is express, but additional clauses will be needed to deal with the array of issues arising from such storage. For charterparties that do not contain an express right for the vessel to be used for floating storage, the position is complicated, compounded if a bill of lading has been issued by owners, and may amount to an unlawful order by charterers.

Voyage charterparties

For voyage charterparties, the situation is even less straightforward. Most voyage charterparties will contain an express term that "the vessel shall perform her service with utmost despatch and shall proceed to such berths as Charterers may specify…or so near thereunto as she may safely get…load the cargo…proceed as ordered on signed bills of lading…and there…discharge the cargo" (SHELLVOY 6). If the term is not express, an utmost despatch term will likely be implied. Any order by charterers to stop the vessel for the purposes of floating storage places the owner at risk of breaching the "utmost dispatch" requirements and any specific bill of lading terms which restrict deviations other than for the safety of life at sea.

Some voyage charterparties expressly provide for the vessel to be stopped or diverted to an alternative port: For example, BPVOY5 (clause 24 Revised Voyage Orders) provides that "Charterers may issue revised Voyage Orders and instruct the Vessel to stop and await orders and/or proceed to an alternative loading or discharge port within the Charter Ranges". However, the precise scope of this provision has not been tested before the courts as regards floating storage, and it cannot be stated with confidence that this clause would, on its true construction, extend to permitting charterers to use the vessel for floating storage.

Under clause 22 of BPVOY4, charterers have a right to cause the vessel to "await orders at one or more location". Under clause 22.2.3, if, after loading, the vessel is instructed to stop and wait at charterers' request, then all time spent by the vessel awaiting orders shall count as laytime or, if the vessel is on demurrage, as demurrage. This may work if floating storage is considered to be within the orbit of clause 22. If it is not, demurrage would likely fall away and be replaced with damages for detention.

In the case of Gard Shipping v. Clearlake Shipping (The Zaliv Baikal) [2017] EWHC 1091 (Comm), the BPVOY4 charterparty, with amendments, provided that if the charterers gave orders for the vessel to stop and wait for orders for a maximum of three days, such waiting time was to count as laytime or demurrage. The additional clauses provided for escalating rates of demurrage after five days waiting for instructions on the basis that the vessel was being used for storage. The vessel arrived at the discharge port and tendered notice of readiness, but charterers did not give any discharge instructions for 64 days. The court held that demurrage was payable at the ordinary rate under the charterparty and not at the escalating rates set out in the additional clauses that applied where the charterers gave a positive instruction for the vessel to stop and wait for orders. It follows that owners need to exercise caution when considering the operative effect of standard form and additional clauses, and be clear as to what rates are intended when the vessel is to be used for floating storage.

In addition, depending on the length of time the vessel is instructed to 'stop', any delay may even trigger an alleged frustration of the voyage charterparty. Mere hardship, inconvenience, or material loss will not frustrate a contract. The doctrine of frustration only arises when an event occurs that is both unexpected and beyond the control of the shipowner and the charterer, and renders it physically or commercially impossible to fulfil the charterparty, or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the charterparty. In all cases, this is a question of fact and law, but given the current issues with terminal and tank farm capacity, such lack of capacity is unlikely to be found to be an unexpected event.

It is therefore of crucial importance that, before any agreement is reached on using the vessel for floating storage, owners consider not only the terms of the time or voyage charterparty but also the bill of lading and their insurance cover.

Practical issues – legal consequences

Aside from chartering and bill of lading issues, there are numerous practical issues that can give rise to varying legal issues as a consequence of an order for a vessel to be used for floating storage.

Cargo degradation

Oil cargoes over time are subject to a variety of risks, including degradation. Crude oil stored at cool temperatures and without sufficient and proper thermal intervention is liable to reach its pour point and become unpumpable. Clean petroleum products may suffer from factors such as gum formation, bacterial growth, instability, or settlement of sediments. A number of cargoes require dosing with additives while the cargo is in the care and custody of the owner. A failure to dose the cargo may prejudice the stability of the cargo. All petroleum cargoes are at risk of evaporation, which over time may manifest in in-transit loss. Owners should seek to amend in-transit loss clause percentage limits to accommodate the increase risk of-in-transit loss from incidents "incidental to the carriage of the cargo" or "loss of a kind encountered on a normal voyage" while the vessel is used as floating storage. Further consideration should be given to materially amending any in-transit loss clause if there is a risk of cargo dissipation from other factors which fall outside the orbit of loss incidental to the carriage of the cargo.

Any of the above incident scenarios may give rise to cargo damage, contamination, or shortage disputes and the risk of rejection and / or claims by cargo receivers who are often third parties to the contract chain.

Owners must also be aware that the Institute Cargo Clauses (ICC) are not specifically drafted with floating storage in mind. For example, the ICC Clause A exclusions (clause 4.5) state that in no case shall this insurance cover "loss damage or expense proximately caused by delay, even though the delay be caused by a risk insured against".

Cargo tanks, and in particular cargo tanks where there has been degradation of the tank coating, may be exposed to aggressive cargoes that may leave residue in the cargo column and cause a failure in the commonly employed clear and bright test. Alternatively, passive cargoes may, over time, become contaminated when defective or porous tank coatings leech contaminants into the cargo column. Both scenarios may result in rejection of the cargo by receivers and a cargo claim against owners.

Owners should also consider to what extent any additional or extended tank cleaning will be required to remove excess sediment from the cargo tank tops and / or impregnation of the paint surface as a consequence of prolonged settling and tank coating exposure to cargoes. Sediment may need to be removed by hand from a VLCC's tanks, and steaming, chemical treatment, or coating maintenance may be needed to return a product tanker's epoxy tanks to a fit condition, with a particular focus on tidal or splash zones that may have suffered from repetitive impact damage.

When contemplating floating storage, it is considered imperative that owners conduct a comprehensive risk assessment to ensure that the vessel is structurally and operationally fit for the purpose of storing the cargo for the periods specified or contemplated, without any material degradation of cargo tanks or the cargo. This assessment should be done at the pre-fixture stage or, if the vessel is already on charter, as soon as voyage instructions are received by way of addendum. Owners should also obtain an indemnity from charterers for any structural or coating damage caused by prolonged storage of cargo in the vessel's tanks as well as for any cargo claims by third parties for any liabilities or losses within agreed margins.

Liability insurance

Before accepting any charterers' instruction directing the vessel for use as floating storage, owners must consider their protection and indemnity, hull and machinery, war, and any other relevant insurance policies, including kidnap and ransom, with a view to confirming cover if the vessel is used for floating storage. If the policy does not cover the time the vessel is to be used or is likely to be used for floating storage, owners need to ask who will be responsible for any additional cover or premium adjustments and have this documented as an addendum to the charterparty.

Hull fouling/hull cleaning issues

While the vessel is employed as floating storage, it is exposed to the risk of hull fouling by marine growth in way of the hull, rudder, propeller, and sea chests. This may impact the vessel's subsequent speed and performance and corresponding warranties given by the owners under the charterparty, leading to under-performance claims by charterers.

Owners also need to be alert to speed warranties that typically state that the vessel "shall be capable of maintaining and shall maintain [a certain speed] on all sea passages". The English courts have construed these warranties as not being limited to the vessel's capacity as newly built, but related to its actual continuing performance. It follows that unless specific wording excluding the performance warranty in respect of voyages after the vessel had been waiting in warm waters is incorporated into the charterparty, the owners will be bound by the express wording of the performance warranty and will not likely be able to rely on any implied warranty to the contrary (The Coral Seas [2016] EWHC 1506 (Comm)).

In the circumstances, owners should consider incorporating clauses that address prolonged stays, including the INTERTANKO Time Charter Storage/Prolonged Stay Clause (clause 4 of which provides that "Any additional costs incurred by Owners during or arising from the Storage Period to be for Charterers' account, including, but not limited to, any tank cleaning/desludging, any additional insurance premiums assessed by Owners' insurers and/or cost of any additional insurance Owners reasonably require. All amounts due to be paid with next hire") or the INTERTANKO Voyage Charter Storage/Prolonged Stay Clause and the INTERTANKO Time Charter Hull Fouling Clause.

Charterers may also advance a claim under the owners' maintenance clause if they can show that the owners breached the obligation to maintain the vessel by failing to adhere to an appropriate anti-fouling programme during the course of the charter or to clean the hull within a reasonable time.

Owners should also be alert to the risk of breaching country-specific biofouling laws, such as New Zealand's Craft Risk Management Standard and should ensure continuing compliance with the 2011 Guidelines for the Control and Management of Ships' Biofouling to Minimize the Transfer of Invasive Aquatic Species (Resolution MEPC.207(62)).

Owners may consider referring to the INTERTANKO Guide to Modern Antifouling Systems and Biofouling Management when considering hull fouling issues.

Before agreeing to store such cargoes for prolonged periods, owners should consult with and seek guarantees from paint manufacturers to preserve their right of recourse against them in the event that tank coatings need to be re-painted due to the prolonged idleness.

Maintenance of safe anchorage position

An important question that may arise during cargo storage onboard is whether the location at which the charterers instruct the ship to wait or drift is 'safe' within the meaning of the charterparty. Usually such stipulation is expressly provided for in the charterparty. By way of example, the widely used SHELLTIME 4 charterparty clause 4(c) requires charterers to "use due diligence to ensure that the vessel is only employed between and at safe places (which expression when used in this charter shall include ports, berths, wharves, docks, anchorages, submarine lines, alongside vessels or lighters, and other locations including locations at sea) where she can safely lie always afloat". Breach of this clause may expose the charterers to an unsafe port (or place) claim.

Other port or place considerations include the quality of the holding ground; the ability to switch anchors in the event of chain fouling or fatigue; the ability to turn the main engine (and the effect of prolonged idleness of the main engine); short steaming requirements; swing zones in the event of strong winds or heavy weather; and the ability to perform underwater inspections meaning owners may have to incorporate lump sum payments in lieu of hull cleaning.

If a vessel is required to depart a floating storage area, and return, owners also need to be alert as to whether this would constitute a voyage and trigger any ballast change requirement.

STS operations

With the increasing use of vessels for floating storage, there is a corresponding increase in the possibility that a charterer may instruct owners to load or discharge the vessel by way of ship to ship (STS) transfer. STS transfer operations bring with them a unique set of risks and potential liabilities to which an owner needs to be alert. In many STS clauses, the obligation is placed on the owner to 'prior approve' tankers and other lightering vessels used in the transhipment process, with such approval not to be unreasonably withheld. In these instances, it is important to note that the English courts look not to whether the owner's approval conduct was correct or their conclusions right. Rather, an owner will only be in breach of their approval decision if no reasonable owner could have regarded their concerns as sufficient reason to decline approval (The Falkonera [2014] 2 Lloyd's Rep. 406).

To assist in managing the risks and liabilities associated with STS operations, owners may consider incorporating the INTERTANKO STS Operations Clause.

Crew welfare and threats to the crew

The impact of the location and duration of any floating storage must be considered in connection with the crew's welfare. The more remote the location, the more challenging it may be to supply the crew with fresh provisions and necessities and arrange access to specialist services such as medical care.

Depending on the location of the floating storage, the vessel may not be able to generate fresh water and may be required to depart from the floating storage area for the purposes of water generation or may be required to proceed closer to shore for the purposes of stemming potable water.

To the extent necessary, owners may wish to consider incorporating BIMCO's Liberty and Deviation Clause 2010 into the charterparty, which gives the owners the liberty of ordering the vessel to "deviate for the purposes of saving life or property, and for any other reasonable purpose, which term shall include but not be limited to calling at any port or place for bunkers; taking on board spares, stores or supplies; repairs to the vessel necessary for the safe continuation of the voyage; crew changes; landing of stowaways; medical emergencies and ballast water exchange".

While piracy and armed robbery have receded in many parts of the world in recent years, the risk is not extinct. Depending on the port or place selected for prolonged storage, owners will need to consider the risk of armed robbery, piracy, and possibly terrorism. This is particularly so given tankers will frequently be fully loaded, have low freeboards facilitating ease of access, be unable to manoeuvre or develop speed at short notice, and be well lit at night.

Owners should consider to what extent they need to comply with industry best practice and in particular the recommendations in BMP5, and whether to include specific risk clauses such as BIMCO's War Risks Clause for Time Chartering 2013 (CONWARTIME 2013) and the BIMCO Piracy Clause for Time Charterparties 2013.

Periodical and other statutory surveys

During a vessel's life, it is subject to an array of statutory and other surveys. If any surveys fall due during the time which the vessel is at the floating storage area, consideration will need to be given as to the feasibility of performing the surveys. It is recommended that once the floating storage duration or expected duration is known, owners consult with their Flag State and Classification Society to determine the scheduling of any surveys and ensure that any extensions are agreed in good time.

Tax considerations

If a vessel is used for floating storage in certain jurisdictions, it may be exposed to tax liabilities that are not otherwise risk allocated within the charterparty. Given that the decision to employ the vessel as floating storage rests with charterers, the starting point is that charterers should be responsible for all tax liabilities that attach to the vessel and the cargo as a consequence of owners complying with charterers' orders. This should be expressly and clearly dealt with in any addendum to the charterparty and not be left for dispute between the parties.

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