The Swedish Club

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Legal issues arising from new bunker sulphur regulations in MARPOL

The Marine Environment Protection Committee (MEPC) confirmed in July 2018 that the new global sulphur limit for marine fuel of 0.50% m/m will apply from 1 January 2020.

Further, amendments to MARPOL Annex VI which prohibit vessels from carrying fuel oil with a sulphur content of more than 0.50% m/m have been approved by the IMO. Such measures will come into force on 1 March 2020, after which only vessels which are equipped with Exhaust Gas Cleaning Systems (i.e. scrubbers), will be exempt from this prohibition.

The technical challenges facing owners are discussed elsewhere; but the new rules also have legal implications, both in terms of compliance, and in relation to the terms of their charterparties, which need to be considered

Legal Framework

MARPOL Annex VI contains rules limiting the main air pollutants contained in ships' exhaust gas. Regulation 14 governs Sulphur Oxide (SOx) emissions, and the sulphur content permitted in fuel oil used on board ships has been progressively reduced in stages, as follows:

SOx limit outside ECAs	SOx limit inside ECAs
< 4.50% m/m prior to 1 January 2012	< 1.50% m/m prior to 1 July 2010
< 3.50% m/m on and after 1 January 2012	< 1.00% m/m on and after 1 July 2010
< 0.50% m/m on and after 2020	< 0.10% on and after 1 January 2015

Compliance with Regulation 14 is mandatory, and that will continue beyond 2020, though "*relevant circumstances*", i.e. mitigating factors, including the non-availability of compliant fuels, will be considered in cases of non-compliance (see below).

Regulation 18 sets requirements in relation to fuel oil quality, and requires amongst other things that a BDN stating the sulphur content of fuel must be kept on board and available for inspection for three years from the date of supply.

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Compliance and Enforcement

Compliance is ultimately enforced by Port State Control (PSC) in coastal states which are party to MARPOL.

It is the individual states who are responsible for determining what "control measure" to take against a vessel for non-compliance: this can include the imposition of fines (the level of which will be set by the state finding the breach), and even the detention of the vessel.

It is the ship owner who pays any fines levied for non-compliance in the first instance, and they will be required to show what was done to try and achieve compliance, which will likely impact on the action taken against the ship. Whether or not any fines or other losses incurred on account of non-compliance are recoverable from a charterer will depend on the terms of any charterparty, and the cause of the vessel's non-compliance.

As far as P&I cover is concerned, members are required to act as a prudent uninsured and follow applicable rules and regulations. Furthermore, cover for fines is generally only available where there has been accidental escape of a pollutant from the insured vessel and the Member has satisfied the Club that all reasonable measures have been taken. Other fines are only covered by the P&I insurance on a discretionary basis.

Practical and Legal Issues

New charters entered into prior to 01 January 2020 but which will extend beyond that date will need to contain specific terms to deal with the new regime. However, ship owners should also review the terms of existing charterparties which extend beyond 1 January 2020. If uncertainty exists then it is advisable to agree certain addenda with charterers so as to avoid any potential disputes in the future.

<u>Example:</u>

Your ship is on a long-term time charter, based on the NYPE 46 form.

The charterparty contains a clause paramount, the BIMCO Bunker Fuel Sulphur Content Clause for Time Charter Parties 2005 and the BIMCO Bunker Quality Control Clause for Time Chartering, and also provides:

"Bunkers on redelivery to be about the same as on delivery: BOD ABT 250 MT HIGH SULPHUR FUEL, ABT 400 MT LOW SULPHUR FUEL", and

"HSMGO USD350/MT, LSMGO USD500/MT BENDS".

Below are some of the issues which might arise, and the differences in that regard between ships with scrubbers and those without:

1) Seaworthiness

Clause 1 and the clause paramount impose on owners a duty to exercise due diligence to make the vessel seaworthy at the commencement of each voyage performed under a time charter. As part of that obligation, Owners must maintain the vessel's class and ensure that she complies with international and national maritime rules and regulations, i.e. is "legally fit" for the chartered service.

i) No Scrubbers

If a vessel requires modifications in order to comply with new legislation, then a failure to make such modifications would render the vessel unfit for the chartered service, meaning all down time and associated costs would be for owners' account. This is as per the court of appeal case of the Ellie & the Frixos [2008] EWCA Civ 584.

Generally, however, unless the terms of the charter require it, an owner is not obliged to install scrubbers. This is on the basis that the vessel will be capable of performing the chartered service using low sulphur fuel. In contrast, if a vessel needed modifications in order to be able to burn compliant fuel, this is for Owners' cost and account. Provided vessels can burn compliant fuels then the vessel will not fall foul of the new rules and will not be unseaworthy, or unfit for the chartered service simply by virtue of having no scrubbers.

ii) Scrubbers Installed

However, some owners are considering installing scrubbers, which will allow vessels to stem higher sulphur content fuels, and 'clean' them to produce emissions which meet the requirements of the rules. Generally, the time and cost involved in the installation of scrubbers is a matter for owners.

Installation of scrubbers will have an impact on owners' maintenance obligations, including crew training, in order to deal with this new piece of equipment. Owners will be liable should their crew not be properly trained in the use of the scrubbers.

Further, if the scrubbers break down the costs of repair will obviously be for owners' account, and if any time is lost in effecting repairs, it will be an off-hire event under clause 15. If excessive low sulphur fuel is consumed due to the breakdown of the scrubbers (which would otherwise allow the use of cheaper high sulphur fuels), then this may also raise a claim by charterers for the difference in fuel prices (subject of course to establishing the breakdown was caused by a breach of charterparty).

2) Cost of Bunkers

Charterers are to provide and pay for all fuel whilst the vessel is on hire (see clauses 2 and 20 of the NYPE). Charterers will be required to supply fuel which complies with the new sulphur limit, in line with ISO 8217 standards, and which is "of a quality suitable for burning in the Vessel's engines and auxiliaries".

i) No Scrubbers

Charterers will be required to provide fuel which complies with the new sulphur limit, the cost of which will be at the Charterers' risk. It has been predicted that the increased costs could be as much as around USD600 per metric ton.

ii) Scrubbers Installed

Charterers will be able to purchase fuel oil with a higher sulphur content (< 3.5% m/m), and will therefore benefit from lower fuel costs in the short term. This is likely to make vessels with scrubbers already installed more attractive to prospective charterers, although a long term charterer may be able to offset these costs by sub-chartering out the vessel.

3) Quality of Bunkers / Removal of Non-Compliant Fuel

Under the BIMCO Bunker Fuel Sulphur Content Clause, charterers are required to supply bunkers of such specifications and grades to permit the vessel to comply with the maximum sulphur content requirement of any ECAs within which the vessel is ordered to trade. This includes all waters regulated by the E.U (EU Directive 2005/33/EC, amending Directive 1999/328/EC).

The BIMCO quality control clause requires charterers to supply bunkers which comply with ISO 8217 standards, and which are "of a quality suitable for burning in the Vessel's engines and auxiliaries".

The above clauses do not expressly deal with the new sulphur limit outside ECAs. Whilst no doubt BIMCO will publish a further clause in due course, the new global limits do not specifically alter the terms of these clauses.

i) No Scrubbers

If the expected prohibition on the carriage of non-compliant fuel is approved then ships without scrubbers will not be permitted to carry fuel with a sulphur content of more than 0.5% m/m beyond 1 March 2020.

In order to assess the relevant control measure (i.e. fine or other measure) States shall "take into account all relevant circumstances and the evidence presented to determine the appropriate action to take, including not taking control measures" (per Regulation 18(2)(c) Annex VI).

At present, it is understood that oil companies are working on perfecting blends for compliant fuel. There remains a question mark as to what extent compliant fuels will be readily available, but fuel suppliers, who will each be looking to steal a march on their competitors, are apparently quietly confident in that regard.

Parties to MARPOL are encouraged to promote the availability of compliant fuels in accordance with Regulation 18.1, but Regulation 18.2 provides that ships should not be

required to deviate or "unduly delay the voyage in order to achieve compliance". However, not all countries with bunkering ports are signatories to MARPOL Annex VI, for example Algeria, Bahrain, Saudi Arabia, and Thailand (interestingly, the U.A.E. is also not a signatory to MARPOL Annex VI. Certain ports within it have taken the decision to comply, although this does not include Fujairah, even though local suppliers appear to have taken a commercial decision that they will comply.)

Where non-compliant fuels are all that is available then (taking into account the vessel's trading patterns and with her safety being of paramount importance), it is possible that necessity will dictate a vessel is supplied with (and will likely have to burn), non-compliant fuel.

However, notwithstanding the terms of Regulation 18, that vessel would still be in breach of Regulation 14. A lack of available compliant fuel acts only as a mitigating factor which would be taken into account by the MARPOL state when deciding what action to take against the vessel for non-compliance. It will not necessarily excuse the breach.

In such circumstances, it is suggested that the consequences of carrying and burning non-compliant fuel would be recoverable from charterers. This is either on the basis that charterers are liable to supply fuels (and have accordingly breached an obligation to supply compliant fuels), and also on the basis of an indemnity for following their orders to stem non-compliant fuel. The fact that non-compliant fuel was not available would not protect charterers from such claims under the charterparty.

A further issue which arises is that a vessel subject to a long term charter may have non-compliant fuel on board post 01 January 2020 (such fuel having been compliant prior to 01 January). Such fuel ought to be removed prior to 1 March 2020. So, who pays for its removal?

If charterers have, prior to 2020, supplied fuel to a vessel which will not comply with the new rules, then if that fuel remains on board, it is suggested that charterers would need to give an order that it be removed prior to 1 March 2020, failing which the vessel will be in breach of the new rules, and Regulation 18(2)(c) would be applied by the relevant state party to MARPOL)

The fuel on board a time chartered vessel belongs to time charterers. Therefore, it is for them to remove it, and it is also theirs to re-sell or re-process as they see fit.

If charterers refuse to give the vessel orders to remove the non-compliant fuel, or do not do so within the relevant time, it is also suggested that the costs of removal would be recoverable from charterers. The legal basis for this would either be breach of an implied term that they are responsible to remove such fuel from the vessel or by way of an indemnity. Any fines levied against the vessel for non-compliance post 1 March 2020 would also be recoverable from charterers.

If non-compliant fuel is supplied after 1 March 2020 on account of compliant fuels being unavailable, vessels will likely be required to remove it at the earliest opportunity (but without having to deviate or unduly delay the voyage), and replace it with compliant fuel. This will again be done at charterers' time and expense.

ii) Scrubbers Installed

Ships with scrubbers will not be required to remove non-compliant fuel, and will be able to continue being supplied with it, and burning it on or after 1 March 2020. This gives such vessels a further commercial advantage.

4) Bunkers on Redelivery / Definition of Bunkers

In our example, the cost of the bunkers at both ends would only apply to HSMGO and LSMGO. Actual cost would apply to all other fuels. However, in relation to delivery and redelivery quantities, bunkers have only been defined as "high sulphur fuel" and "low sulphur fuel", in line with the two categories of bunkers available today.

It may of course be the case that the charterparty fuel prices (agreed pre 2020) do not reflect the cost of buying fuel post 2020. However, the parties will be stuck with the bargain that they have reached, with the result that charterers in our example could end up 'selling' bunkers on redelivery to the owners at a significant discount. From 2020 however there will be three categories: fuel with sulphur content of (a) < 0.1% m/m, (b) < 0.5% m/m, and (c) < 3.5% m/m.

It is suggested that post 2020, in all cases, "low sulphur fuel" should sensibly be interpreted to mean fuel with a fuel sulphur content of < 0.1% m/m. So the charter prices would apply accordingly.

i) No Scrubbers

Vessels with no scrubbers installed will not be permitted to be supplied with or burn todays so-called "high sulphur fuel".

In such circumstances it is suggested that "high sulphur fuel" on redelivery should sensibly mean fuel with a sulphur content of < 0.5% m/m, i.e. category (b) above.

ii) Scrubbers installed

Vessels with scrubbers installed will be permitted to carry fuel with a sulphur content of < 3.5% m/m.

In such circumstances it is suggested that "high sulphur fuel" on redelivery would mean fuel with a sulphur content of < 3.5% m/m, i.e. fuel which meets the current global limit (category (c) above).

A sensible solution would be for parties to discuss addendums to their existing charterparties to deal with any uncertainty over the quantity and cost of specific fuels.

5) Switching Fuels

Different limits on sulphur emissions exist inside and outside of ECAs, and this will continue beyond 2020. Switching fuels has become commonplace, and will also continue.

Crew competency issues sometimes arise when vessels switch to different fuels and cases have arisen where breakdowns and delays have occurred due to switching over fuels. If issues arise from switching fuels, then the vessel will be off-hire, and owners would not be entitled to an indemnity from Charterers. Such matters are for owners as they relate to the use and management of the vessel.

6) Performance Warranties

Charterparties usually contain performance warranties giving specific speed and consumption allowances for different fuels. The performance warranties given on vessels with scrubbers are not likely to be affected.

However, any warranty given for specific fuel types may no longer apply, or may need revision.

Owners should check the wording of performance warranties in existing charterparties, and should not provide performance warranties relating to any new fuels without knowing how the vessel will actually perform whilst using them (owners may wish to speak with engine manufacturers in that regard).

7) Scrubbers – costs involved

The costs of scrubbers can range from around US$900,000 to US$3,500,000, and that does not factor in installation costs. If a vessel is fitted with scrubbers, then their maintenance is for owners as already discussed.

The cost involved in disposing waste from scrubbers is not expressly dealt with under the charter. However, even if owners need to foot the bill in the first instance, it is suggested that these costs would likely be recoverable by way of an indemnity from charterers. The logic of this is that waste is created by following their orders (to burn fuel with a higher sulphur content and use scrubbers).

Going Forward

Owners will also want to give consideration to all of the above when entering into charterparties going forward.

In the future, bunkers should not be defined as "high" or "low" sulphur, but with reference to their sulphur content or as MARPOL Annex VI compliant. Appropriate consideration will need to be given to consumption warranties and prices on delivery and redelivery.

In the lead up to January 2020, owners will need to ensure appropriate measures are in place to remove non-compliant fuel. If that fuel cannot be burned or removed prior to the cut-off date, then owners will face sanctions from States who are party to MARPOL.

Vessels with scrubbers fitted are likely to be at a commercial advantage in the short to medium term, although it cannot be said with any degree of certainty how long this will last. Much will depend on the oil industry's ability to respond to the technical issues faced in producing abundant quantities of compliant fuel.

Conclusion

As can be seen there are various issues which ship owners need to be thinking about, both in terms of existing charterparties and in charterparties entered into in the future.

If owners are in doubt about the provisions of any existing charterparties, or over what to include in future charterparties, we recommend that owners should seek further and more specific advice.

Finally, a word of caution. Being observant to local regulations is particularly important since regulations may vary from port to port. For instance, the Club has received information that Singapore will ban the use of so called "open loop scrubbers" which discharge wash water from the scrubber directly into the sea (albeit after certain treatment).

This text has been provided with kind assistance from Ince & Co lawfirm.