UK DEFENCE CLUB

Soundings

Sulphur Series: Countdown to 2020

2020 bunker pricing issues

Under a time charter, the charterer is usually responsible for fuel and the owner for compliance with MARPOL whereas under a voyage charter an owner would generally be responsible for both. Whilst this should make the position more straightforward, one crucial question will be how best to mitigate the potential impact of volatile fuel prices linked to 2020.

The effect that the new MARPOL provisions will have on bunker prices is not yet clear, but it is expected to be significant. The cost of low sulphur fuel is currently about 15% higher than high sulphur fuel and some anticipate there will be a spread of about US$330/mt between the two fuels in 2020. On any assessment, the surge in demand for low sulphur fuel, coupled with concerns as to refinery capacity, is likely to result in price rises and fluctuations while the market settles out.

continued overleaf

One point to note here is that, the major bunker price reporting agencies have only very recently started to publish assessments for 0.5% low sulphur grades. Whilst these are at present hampered by a lack of market liquidity, going forward owners may wish to consider which of these may be most appropriate for their needs.

Bunker adjustment clauses

Bunker escalation clauses

Bunker adjustment clauses are commonly adopted where price instability makes predicting the cost of performance difficult. Some types of provision, more accurately referred to as "bunker escalation clauses" provide for increases in freight only where bunker prices go above a stipulated ceiling. In anticipation of 2020 fuel price volatility, such clauses are likely to become indispensable to owners with long term COAs.

There are several variations of such clauses and some drafting points are worth considering. As a starting point the BIMCO Bunker Price Adjustment Clause might be adopted:

> *"This Contract is concluded on the basis of a bunker price of USD _____ per metric ton for _____ oil* of _____ grade. If the bunker price per metric ton at _____** on the first day of loading is higher than USD _____ or lower than USD _____, any amount in excess of such increase or decrease shall be payable to Owners or Charterers as the case may be."*

This is a relatively broadly worded provision that contemplates adjustment where the price of bunkers on the first day of loading falls outside a stated range. More complex formulae may be appropriate where prices are extremely volatile and where, therefore, the price of bunkers on a single date may not represent the costs incurred during the entire charter.

The BIMCO clause does not account for the potential need to switch between different types of fuel. This may be relevant for contracts of affreightment (COAs) that are due to transit into 2020 or where ships have scrubbers installed and there is an option to use either low or high sulphur fuel, as appropriate. There is also no provision for price adjustment in relation to 0.1% sulphur fuel, which is used in emission control areas.

Bunker adjustment factor clauses

Some provisions provide for freight to be adjusted where bunker prices, as evidenced by a specified recognised index, such as that published by S&P Global Platts, go above or below certain parameters. Such a clause might provide, for example, that the freight rate is to be increased or

decreased by US$ xx for every US$ xx difference between the base rate and a Platts assessment as at xxx date.

One point to note here is that, the major bunker price reporting agencies have only very recently started to publish assessments for 0.5% low sulphur grades. Whilst these are at present hampered by a lack of market liquidity, going forward owners may wish to consider which of these may be most appropriate for their needs. Alternatively, whilst indices for low sulphur fuel are still being established, a bunker escalation or de-escalation clause may be preferred by some.

Another consideration with this type of provision is the date on which any such marker should be tracked. It is common to refer to the price as at the bill of lading date or the price as at the date the stem is purchased. Where prices are fluctuating heavily on a daily basis, the date used as a reference point can have a big impact on freight calculations and historic dates may not accurately reflect recent changes.

Outdated clauses?

Difficulties may also arise in relation to existing voyage charters, typically long-term COAs. These may contain bunker adjustment clauses which were not drafted with 2020 in mind and which therefore apply a pricing index or adjustment mechanism that is not relevant to low sulphur fuel. For example, clauses which provide for an adjustment of freight in relation to IFO price movements only. There may be questions as to whether such clauses can be interpreted to apply to different types of fuel, i.e. low sulphur.

Owners might argue that the parties' agreement to a bunker adjustment clause reflects a more general intention that bunker prices generally should be adjusted or escalated to protect parties from market volatility or price rises. However, although clauses will need to be looked at on a case by case basis, in general it is likely to be difficult to construe such bunker adjustment provisions as applicable to a situation they were clearly not designed to cover.

These difficult issues of construction, essentially involving the application of a contractual term to a situation that was not contemplated at the time the contract was entered into, may be avoided if the parties are able to negotiate new provisions, tied more closely to the requirements of the new

Many major carriers have already indicated or announced that they will be implementing fuel surcharges, bunker adjustment factors, or other appropriate mechanisms to address the higher rate of lower sulphur fuel.

regime. In many cases, however, owners may have to work with bunker adjustment clauses which no longer enable them to adjust freight to reflect bunker price increases.

Comment

This issue is therefore one that owners will need to address under any voyage charters in order to mitigate the financial impact of 2020. It is especially relevant for disponent owners who have themselves time-chartered in ships and may therefore be even more at risk from to sudden movements in prices. Although it may be that the market will adjust itself in due course, it would be wise to take precautions.

Many major carriers have already indicated or announced that they will be implementing fuel surcharges, bunker adjustment factors, or other appropriate mechanisms to address the higher rate of lower sulphur fuel. In turn, therefore, the increased costs associated with 2020 are likely to be passed along the contractual chain to shippers and, in turn, to the end consumer. In this way, the impact of IMO 2020 is likely to be felt beyond the shipping industry and into the general global economy.

Members are invited to contact the Managers with any queries related to this or any other issues related to the 2020 sulphur regulations.

The UK Defence Club
Thomas Miller Defence Ltd, 90 Fenchurch Street, London, EC3M 4ST
tel: +44 207 283 4646 fax: +44 207 204 2131
email: tmdefence@thomasmiller.com web: ukdefence.com