



LNG – Standard Form Charters

This paper provides an overview of the standard form charters available to the LNG shipping market, their use and other mechanisms which might also be considered.

ShellLNGTime1

Since it was issued in November 2005, the ShellLNGTime1 form has been widely relied upon as the basis for LNG time charters from single trip to long term period.

a matter of balance

In the context of many of the charterer-friendly long-term charters of the period, it was relatively balanced. The non-LNG specific provisions are mostly lifted directly from the ShellTime4 form (2003 Edition), itself aimed at crude oil trade, but a widely accepted basis for time chartering in the wider oil trade. The benefit of this is obvious: there is ample jurisprudence as to the construction of its provisions (the original form was issued in 1984 and much survives in the later editions).

and imbalance

Whilst the latest edition of ShellTime4 might be regarded (rightly) as a charterer-friendly form, by comparison to many LNG charters of the time, it was quite balanced. The mutuality of the earliest ventures in long term LNG chartering had given way to very much more charterer-dominant drafts being offered to those keen to enter into LNG shipping.

the problem with boil-off

The LNG provisions in ShellLNGTime1 derive from Shell's experience in LNG chartering (at the time, Shell was both chartering in and out, so a pragmatic balance was sought when drafting the provisions). The main distinction between the LNG and oil trades that the ShellLNGTime1 form has to address is the cargo (and heel) boil-off.

For example, the consequences of having retained inadequate heel to arrive with cargo tanks ready to load LNG is one such issue that arises. Here, the ShellLNGTime1 provision allocates the charterer's and owner's risk respectively between the charterer's employment or the owner's operational causes, save for in the event of need post requisition. Less obviously the risk for the requisition lies with the owner, even though the ambit of this is beyond requisition by the flag state of the vessel and will in fact

reflect where the vessel is employed.

*milk runs and
Scheduled Arrival
Times*

Other notable differences between ShellTime4 and ShellLNGTime1 are that ShellLNGTime1 abandons the warranted service speed approach of ShellTime4 and, for that matter, most other time charter forms. Instead it adopts a 'Scheduled Arrival Time' mechanism that requires the vessel to meet (achievable) scheduling requirements by adjusting its performance speed to match the required ETA. It is also worth noting that the charterer-friendly wind speed limit of Beaufort force 8 in ShellTime4 is abandoned in favour of a more reasonable force 5 in ShellLNGTime1 (albeit swell is still excluded).

The form reflects its age in a number of respects.

*the Fuel Oil Equivalent
and steam plant,
dual/tri-fuel diesel
engines*

It was issued ahead of the first DFDE (dual-fuel diesel-electric) deliveries in 2006, when steam turbines were still the norm (their reliability and ability to use boil-off overcoming their comparative inefficiency over diesel engines). This is clearly reflected in 'Form B', which assumes steam plant. However, as the steam plant's boilers were also dual-fuelled and the generators were diesel engined, main body provisions and Appendix C (with their 'Fuel Oil Equivalent' concept) read consistently with the requirements of DFDE (and now tri-fuel engines). There is an absence of an express reference to the owner having to provide lubricating oil, however, this derives from the ShellTime4 form and not from any steam-centric outlook of ShellLNGTime1.

STS operations

In 2005, there had only been a fairly limited number of STS operations between LNG carriers, there were no LNG-specific STS guidelines issued (only those deriving from the LPG trade) and there were some vocal opponents within the industry to the growth of the practice. Since then there have now been a significant number of such operations performed (with Excelerate leading the way), SIGTTO guidelines (that we assisted in the drafting of) have been published and it is common now for owners to permit STS operations (usually subject to the SIGTTO guidelines being observed).

*reliquefaction plant - on
the ship but off the form*

The form has no specific provision for re-liquefaction plant being fitted. It pre-dated by two years the delivery of the first of the Q-Flex and Q-Max vessels that were built with reliance on re-liquefaction plant. These vessels were, in any event, all built with charters on the ExxonMobil2000-derived LNG form (that we assisted in drafting). However, smaller scale re-liquefaction plant has also been fitted on modern LNG carriers as an alternative to relying upon gas combustion units to deal with boil-off.

Suitable periods

*intentionally inadequate
for long-term chartering*

The provisions of ShellLNGTime1 are intentionally inadequate in terms of scope to address the concerns of long term chartering. Even if not entered into in association with a building contract (and any co-existing financing arrangements and bareboat

options), the absence of hire indexing (often in relation to a carved out OPEX element) or project specific force majeure provisions are obvious absentees.

still a need for some boiler plate clauses – even for short-term chartering

It is used in the short term market with often quite light amendments and, in stark contrast to equivalent oil trade period (albeit with quite a different outlook as to what ‘long’ and ‘medium’ term means in relation to period) charters under its stable mate ShellTime4, additional clauses are quite limited in number. The obvious boiler plate clauses and necessities that are omitted from the standard form (e.g. a piracy clause and adequate tax clause) being good examples of the few additional clauses required.

The lightness of these amendments are particularly notable where the terms are carried over from ShellTime4. Common place amendments, such as express reliance on the Q88 Questionnaire or the reservation of premia for blocking and trapping policies for owners’ account, are scarcer.

General Average and a right to tranship

To some extent, optimism in the face of the industry’s track record for safety may explain this. A good example of this is with respect to General Average. Negotiating a specific right to the release of cargo for transhipment in return for entering into a non-separation agreement (which makes obvious sense in the context of boil-off) is a more common negotiated provision in ShellTime4 based oil charters.

minimal adaptation for use as a trip-time-charter

Where employed for use as the basis for a trip-time-charter, the need for adaption of ShellLNGTime1 is minimal (indeed, its remarkably unsophisticated approach to bunker pricing is probably best suited to such charters). For example, the LNG retention provisions are clearly irrelevant in the context of a trip charter, but as the drafting provides for charterers’ orders and agreement as to heel these do not need to be deleted. Indeed, clumsy amendments of the delivery and redelivery provisions are a not uncommon source of delay in the terms being agreed (or concern if not addressed).

heel out don’t strike out

Injudiciously drafted variations for notional redelivery way-points and heeling out requirements make (what are in effect) already owner-friendly provisions even more so. For example, although the intention might be to redeliver heeled out, blithe deletion of the provisions that deal with buy-back of LNG (as heel) potentially leave the owner with an additional wind-fall in the event of early redelivery (e.g. in relation to a repudiatory breach or permitted withdrawal, such as for non-payment of hire).

precision, harmony and Heads of Agreement

Trip-charters are also often negotiated and fixed by way of Heads of Agreement (‘HoA’) ‘logically amending’ the standard form. Whilst convenient, a lack of precise language or failure to harmonise concepts or terminology naturally (albeit unnecessarily) creates avoidable construction issues.

Voyage chartering

*a significant feature of
the oil trade*

The high on exclusive use of time charters in connection with LNG carriers is in stark contrast to the oil trade. However, the LNG spot market is much less developed. Until recent years, LNG carriers were built to form part of the value chain for LNG projects and to serve long term sale & purchase or off-take agreements. Speculative building of LNG carriers is a more recent feature, as are the exceptional returns that the market has offered of late.

*more of a talking point
for LNG?*

We are only aware of two voyage charter fixtures in the last decade or so, one of which we drafted in short order to deal with an unusual set of circumstances. Even where LNG carriers are fixed to perform single voyages (a phenomenon that has increased over the last decade) a trip-time-charter is still the norm.

The GIIGNL form

Finalised in April 2012, after some years of being circulated in draft form, the GIIGNL 'VCP' was issued in May 2012.

talk of desire

The accompanying notes to the form refer to an *"increased demand for spot or short-term trades which has fuelled the desire for a more voyage specific charter format"* (although, for GIIGNL, *"short-term"* means a contract of four years duration or less).

unrequited

Given that GIIGNL represents LNG importers, it is perhaps unsurprising that they have promoted the use of voyage charters in the LNG trade. However, it was issued at a time when LNG charter rates were at a historic high, in what is and remains very much an owners' (short term) market. These owners will see no benefit in the conceptual similarity between voyage charters and LNG trading agreements (e.g. laytime and demurrage provisions) and are unlikely to share the *"desire"* that GIIGNL's members may have felt.

The development of the form reflects this position. Earlier drafts amounted to a more charterer-friendly form. However, by the time that the form was issued more owner-friendly positions were adopted.

*the unqualified warranty
of safety*

An obvious example of this shift in position is that of the warranted safety of the ports. Rather than adopt the requirement that charterers exercise due diligence as to the safety of a port (familiar from ShellLNGTime1, ShellTime4 and Shell's voyage charter ShellVoy6), there is no such qualification in the warranty. Given the growing use of STS operations and FSRUs to create fast-start reception terminals in new markets and their corresponding reliance on spot or short term commitment for supply, perhaps this is unsurprising (indeed, the form clearly contemplates both circumstances), notwithstanding that it is perhaps counter to the trend in modern tanker voyage

*very much consistent
with the trend in LNG*

*Master S&P
agreements*

charters. Further, it should be noted that it is very much consistent with the trend in LNG Master Sale and Purchase Agreements for the buyers and sellers (one of which is usually the charterer) to offer warranties of safety as to the berth and facilities that the LNG carrier must use (which may vary depending on the deal struck under each 'Confirmation Notice'). Given the extraordinary safety record that the owners of LNG carriers have established, and that the industry as a whole needs them to maintain, requiring a charterer to warrant the safety of a port is arguably a means of upholding high standards of safety. A charterer is more likely to give careful consideration as to their employment orders where the potential exposure to liability is greater (the safety of the port/berth and the compatibility of the LNG carrier with the terminal not amounting to the same thing in law). However, by the same token, given that safety record, perhaps the warranty may seem something of a sop to owners, particularly in comparison to the present commercial attractiveness of a trip-time-charter.

*a hint of old fashioned
morality?*

In contrast to a time charterer, a voyage charterer does not have the right to issue employment orders, as these would impact upon the commercial bargain upon which freight was agreed. For LNG carriers, aside from itinerary and scheduling issues, this removes flexibility with respect to the use of natural or forced boil-off. In a voyage charter all such decisions have to be taken when the fixture (and freight) is agreed. However, as these considerations should go somewhat hand-in-hand this lack of flexibility should be of little practical limitation. Further for many modern LNG carriers inadequate boil-off is rarely an issue on a laden voyage (hence reliance on gas combustion units or re-liquefaction plant).

*the challenge of
addressing boil-off in a
voyage charter*

Boil-off presents other challenges for a voyage charter format. In an effort to achieve consistency with the calculation of freight, the VCP fixes the allowable boil-off (loss of LNG volume) between dropping the last outward sea pilot (DLOSP) and Notice of Readiness (NOR) at the discharge port. The volume being derived by application of the boil-off warranty (percentage) to the notional (not actual) voyage duration. However, to allow for this, the VCP necessarily requires the crew to conduct gauging at these points of time, both of which would ordinarily be when the vessel is in a seaway.

As the name suggests, this relies upon the use of level gauges in each cargo tank and specific tables to convert the observed ullage into a volume. Correcting factors for trim and list are then applied (particularly important for, non-spherical, membrane containment systems).

*the need to gauge
cargo tanks in a seaway*

Gauging in a seaway must introduce sloshing (liquid movement) as a factor that must be added into the equation, as an LNG carrier's cargo tanks are never (intentionally) fully filled. Sloshing undoubtedly prevents accurate gauging, as does pitch and heel. Anecdotally, even when gauging alongside, the recommended procedure is to take the

average of five readings spaced by thirty seconds. For a 140,000cbm LNG carrier with a membrane containment system, every 1cm variation in ullage would equate to around 25cbm (about 500MMBtu). Therefore, only a 10cm error in ullage would equate to an entire day's warranted boil-off (about 210cbm for such a vessel, basis an allowance of 0.15% pd of the cargo tank volume). To put this in context, the tolerable accuracy of level gauges (for LNG carriers) is +/- 7.5mm, which for that same vessel equates to a variable of about 23cbm.

the absence of any balancing mechanism

This is unattractive for an owner as there is no balancing mechanism between the two warranted periods ((i) load port custody transfer system ("CTS") to DLOSP gauging and (ii) NOR to discharge port CTS) and the capped warranty on the sea passage. Therefore although the warranties might be complied with over the entire voyage, there is no system to offset a saving against an excess. This adds a further layer risk for the owner, over and above the inherent risk of weather delays (or others that are external to the owner) in voyage chartering.

only tempting cynicism

The clear temptation for the owner would be to record the DLOSP gauging using the full extent of the available warranty and adopting a similarly cynical approach at the other end. For some of the world's terminals this consideration may seem something of a sideshow. However, there are those with longer navigation elements between POB and CTS and it must be noted that the warranted period covers time on demurrage too, as the liquidated damages provisions (demurrage) do not relieve the owner of the warranty as to boil-off.

laytime and demurrage provisions do not mirror the norm in LNG Master S&P Agreements

It is also worth noting that the laytime provisions of the VCP do not mirror the norm in LNG Master Sale and Purchase Agreements: where, for example, laytime for loading usually ends on disconnecting the loading arms and (often) upon completing clearance and being able to depart. Therefore the notable recent trend (in LNG Master Sale and Purchase Agreements) towards demurrage boil-off being gauged rather than applying the warranted boil-off rate does not attract the same concerns as the mechanism in the VCP.

volume rather than energy as the measure

It is also notable that whereas there has been a shift towards energy based evaluation of boil-off in chartering (reflective of the measure in sale contracts), rather than reference to volume (with a fixed energy conversion value), the VCP does not attempt to be progressive in this respect.

the need for additional clauses

The VCP (intentionally) requires additional clauses (obvious omissions include the absence of an ISPS clause) which perhaps runs contrary to the intention that the VCP will facilitate easy to conclude fixtures. That said, the ShellLNGTime1 is similarly short of some boiler plate clauses (e.g. a piracy clause or adequate tax clause) and that has

not harmed its popularity.

*immaturity of the market
is a stumbling block*

The real difficulty for the VCP would seem to be the state of the market and the degree of comfort with, and the ease of adoption of, the ShellLNGTime1 form for use as a trip-time-charter. Whilst voyage charters might be common place for oil tankers, that market is much more mature; there is no shortage of available tonnage, there are back haul cargoes to be had and physical compatibility issues are much more generic.

Contracts of Affreightment ('COA')

As discussed above, with a time charter, the charterer carries the commercial and natural (e.g. delay due to bad weather) risk during the charter period. Although, arguably, ShellLNGTime1 does seek to pass some of the latter risk to the owners by excluding swell height from the definition of Adverse Weather Periods (albeit less extreme than ShellTime4). By contrast a voyage charter passes the natural risk en passage to the owner alone.

*performance is not
limited to the services
and availability of a
specific vessel*

A time charter is for a specific named vessel and rarely is there provision for a substitute. If the performing vessel is out of service, the owner is under no obligation to provide a substitute and is unlikely to be liable in damages for the wider effects of non-performance; loss of use and compensating any consumption of charterer's bunkers (and boil-off in the LNG trade) being the usual limit of exposure. A voyage charter more commonly does permit alternative vessels to perform (if they fit within the generic requirements), particularly where wider delivery windows are offered or consecutive voyage charters are agreed.

With a COA these characteristics are typically less distinguishable. The time risk lies with the owner in the sense that if there are weather delays the owner will still earn the same freight. Stoppages or under-performance will also be at owner's risk, however, the same outcome is achieved under a time charter, by way of off-hire or damages for under-performance.

However, the owner will have the use of his vessel(s) between the voyages to be performed for the charterer. Therefore the owner requires sufficient notice of when the charterer needs a performing vessel. There is thus need of a well-developed system of notification.

*use of COA in other
trades and balance
sheet advantages*

Where demand is insufficient for a 'milk run', but there is no appetite for accepting the commercial risk of time chartering a vessel for a period, a COA might ordinarily be considered in other trades. Particularly as there is also a potential advantage in terms of accounting: in so far as a COA could be distinguished from a 'lease' within the meaning of IAS17 (so as not to characterise it as an asset: to keep it off the balance sheet).

Essentially a volume contract, these will normally provide for a number of voyages to be performed within a certain period with certain volumes (min / max) of cargo and between certain ports. These will not be consecutive, as otherwise consecutive voyage charters (or even a time charter) would adequately address the requirement. However, the end performance should require the voyages to be spread across the period of the COA, allowing the owner sufficient flexibility to make the arrangement commercially attractive.

with COA the prospect of a frustrating occurrence is minimised

With COA it is a common provision that if the vessel intended by the owner to perform cannot do so, the obligation to lift the cargo will usually remain extant and a substitute will have to be provided. The prospect of a frustrating occurrence, at least with respect to the vessel, is therefore minimised.

no standard form COA directly suitable to LNG

A COA is usually composed of a frame agreement, encompassing the general terms, supplemented with an agreed form voyage charter for each individual voyage. For the oil trade, Intertanko's INTERCOA is a standard form frame contract designed to be supplemented with the Intertankvoy form of voyage charter. There is presently no standard form COA directly suitable for the LNG trade (even with the introduction of the GIIGNL 'VCP').

In other trades it is common not to identify performing vessels, other than generically in terms of size and type (e.g. geared supramax in dry bulk trades), so as to permit flexibility for the owners. However, compatibility would likely be a dominant factor for any LNG trade COA.

compatible with arbitrage

There is no reason why a COA should not be compatible with arbitrage. For example, a variety of potential loading terminals (e.g. within the Atlantic basin) could be accommodated by providing corresponding freight variations and adequate notice periods.

avoid loose concepts in COA, such as "evenly spread"

Where disputes arise under a COA, it is often due to one of the parties wishing to take advantage of shifts in charter/freight rates. However, this is no different to the situation that may arise under a time charter. The lack of an available vessel to perform and (where permitted) the reluctance (or inability) of an owner to charter in a substitute at market rate, is a similar source of dispute, and not dissimilar to what may arise under a voyage charter. However, one dispute that is peculiar to COAs is in relation to the delivery schedule. The reliance on loose concepts, such as determining that voyages shall be "evenly spread" (or "fairly evenly spread") has spawned many a legal proceeding. The results of such loose terms are often hard to predict. However, careful structuring of the delivery obligations can avoid this problem, supplemented by over-lifting and short-lifting provisions, to deal with divergence from the intended delivery programme.

there is no reason why an agreed form time-trip-charter cannot be used within a COA frame agreement

In principle there is no reason why an agreed form trip-time-charter (i.e. a suitably amended ShellLNGTime1 form) cannot be used within a COA frame agreement. However, the simplicity (a main attraction) of the commercial arrangement is lost. That said, there are instances where these alternative arrangements might be beneficial. The recently headlined co-operation between Golar and LNG Partners in relation to the proposed Douglas Channel project, might be such an example.

perhaps it will be in the framework of COA that voyage charters 'find their feet'

With the LNG shipping market yet to embrace voyage chartering, it may seem unlikely that COA will become a feature of the growing spot market for some time to come. However, perhaps it will be within the framework of COA that voyage charters 'find their feet'. An ancillary feature of such a development might be the entering into pooling agreements between owners of uncommitted (to projects) LNG carriers. However, it will likely take a dramatic downturn in the market before either are seen.

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Marcus specialises in marine and off-shore matters, handling both a contentious and non-contentious work load.

With respect to LNG, he has been engaged in the reviewing and drafting of:

- long-term (with associated build contract and bareboat charter) and short-term time/trip/voyage charterparties, fleet master services and management agreements for LNG Carriers, and
- LNG terminal use agreements, conditions of use, operation and maintenance agreements, technical manuals, service contracts for terminal support vessels and various other contracts relating to the provision of Port Services, Emergency Towing and the maintenance of Aids to Navigation.

He also regularly works with our trading lawyers in relation to the review and negotiation of LNG Master S&P Agreements and has acted as a legal adviser to SIGTTO for many years.

In addition, Marcus has acted in a wide variety of 'dry' shipping disputes (e.g. charterparty, carriage of goods, MOA, ship management) and has broad experience of admiralty matters, to which he brings the benefit of practical experience, having previously sailed as a ship's master.

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