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Poseidon Principles: Legal Directions for Implementation & Enforcement

Pia Rebelo

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Pia Rebelo
The City Law School

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Abstract

A group of global banks led by Citi, Société Générale and Danske Bank have collaborated to formulate a framework known as the Poseidon Principles, which will limit lending to shipping companies that fail to uphold increasing environmental standards. Signatories to the green deal will integrate climate considerations into lending decisions with the objective of achieving decarbonisation in the industry. This raises a number of questions pertaining to the contractual obligations that Signatories will impose on Borrowers in their financing agreements. This Paper specifically addresses the question of enforceability and the legal consequence of the Poseidon Principles Standard Covenant Clause (SCC), its available remedy, and the incorporation of environmental obligations into financing agreements. This Paper calls for a gradual implementation of stricter enforcement mechanisms as a set of green norms become increasingly pervasive throughout the shipping sector. The Poseidon Principles framework can become a powerful private governance tool in achieving international climate change goals through providing both directional industry guidance and legal avenues for accountability.

Keywords: [Poseidon Principles; Covenant; Clause; Shipping; Environmental]

Introduction

The challenges of the International Maritime Organisation's (IMO) initial agreement to reduce GHG emissions by 50% by 2050 compared to 2008 should not be underestimated.¹ This goal, accompanied by strengthening environmental standards for other emissions and biological impacts, faces a number of challenges – the greatest of which is costs. New shipbuilding designs and vessel retrofits require immense capital injections in order for owners and operators to comply with IMO standards.² Therefore, 'green financing' for an industry transition has become crucial to achieving the IMO's vision of a Sustainable Maritime Transport System.³ If financiers are to play their part in the IMO collaborative agenda, then banks need to incentivise their shipping clients through innovative schemes of gaining access to capital through environmental compliance and adherence to IMO requirements. In addressing this gap, a group of global banks led by Citi, Société Générale and Danske Bank have collaborated to formulate an agreement which will limit lending to shipping companies that fail to uphold increasing environmental standards and to reduce greenhouse gas emissions.⁴ Signatories to the green deal will integrate climate considerations into lending decisions with the objective of achieving decarbonisation in the industry. This framework, known as the Poseidon Principles, is aimed at aligning the shipping industry with the IMO 2050 requirement through requiring Signatories to assess the sustainability of vessels within their shipping portfolios using an annual efficiency ratio of grams of CO₂ per ton-mile. Signatories will be held accountable for disclosing whether their shipping portfolios are aligned with the Poseidon Principles framework agreement, meaning that 'bank liquidity will be prioritised for those clients supporting IMO target levels'⁵.

There is already significant 'buy-in' to the Poseidon Principles between law-makers (namely the IMO and States), banks, and industry actors – who all need to take steps to effectively implement the governing principles. A commitment to elevating the Poseidon Principles beyond mere aspirational goals will require the gradual implementation of contractually

¹ MEPC 72 adopted resolution MEPC.304(72) on Initial IMO Strategy on reduction of GHG emissions from ships

² Lloyd's Register Group Limited and UMAS (2017) 'Zero-Emission Vessels 2030: How do we get there?', Part of the Low Carbon Pathways 2050 Series

³ For more on the IMO's Concept of a Sustainable Maritime Transport System, see <<http://www.imo.org/en/About/Events/WorldMaritimeDay/WMD2013/Documents/CONCEPT%20OF%20%20SUSTAINABLE%20MARITIME%20TRANSPORT%20SYSTEM.pdf>> accessed 4 March 2020.

⁴ Poseidon Principles (2019) < <https://www.poseidonprinciples.org/>> accessed 16 November 2019.

⁵ Paul Taylor, Global Head of Shipping & Offshore, Société Générale CIB was quoted as making this statement at the launch of the Poseidon Principles in New York, June 2019, as reported by Barry Parker, 'The Poseidon Principles and a 'green transformation' of shipping', *Seatrade Maritime Review* (20 June 2019).

enforceable obligations with all the consequences that follow from a breach of agreement. Currently, compliance with the Poseidon Principles is to be incorporated into contractual agreements between Signatories, clients and partners, through standardised covenant clauses (SCC) which will be continuously updated in the annual review process.⁶ The enforceability of green covenants in finance agreements has wider relevance as private environmental governance is increasingly explored in the context of climate change targets for international shipping.⁷

This article acknowledges, as a starting point, the normative value of the Poseidon Principles objectives. It then looks to the future as to how the Poseidon Principles framework will be given increasing legal effect in bank loan agreements between Signatory Lenders and Borrowers. From a methodology perspective, this article will analyse and systemise ways to include the Poseidon Principles in loan agreements to predict the possible developments in contractual enforcement mechanisms. The nature of the current Poseidon Principle SCC will be critically analysed for its current legal effect, with an aim to increasing its weighting in loan agreements further down the line. This investigation is conducted within the confines of an English Law framework as the prevailing legal system of the international maritime sector. The Poseidon Principles Association has also declared English law as the governing law and jurisdiction for agreements between the Association and Member banks, and therefore the applicable law in terms of disputes arising out of such agreements.⁸ The method employed will be to gauge English doctrinal sources, namely contract law materials, to provide significant enough remedies to not only deter borrowers from breaching their obligations, but to incentivise effective implementation of a set of environmental objectives and actions.

In terms of scope, the potential nature of Poseidon Principle contractual terms are discussed within the context of debt financing for the obvious reason that the Poseidon Principles must be applied to the following credit products: bilateral loans, syndicated loans, club deals, and guarantees. Although shipping finance has evolved significantly since the 2008 financial crisis, with shipping companies relying more on the capital markets to diversify funding sources, the predominant form of shipping finance still remains the traditional bank loan.⁹ This prevalence

⁶ Poseidon Principles, *Technical Guidance* https://www.poseidonprinciples.org/wp-content/uploads/2019/07/Poseidon_Principles.pdf accessed 1 December 2019, 24.

⁷ Jane Lister, 'Green Shipping: Governing Sustainable Maritime Transport' (2015) *Global policy* (1758-5880), 6 (2): 118.

⁸ See Membership Agreement relating to the Poseidon Principles Association < <https://www.poseidonprinciples.org/wp-content/uploads/2019/09/PPA-Membership-Agreement-05.09.19-editable.pdf>> accessed 24 February 2020.

⁹ George Alexandridis et al 'A survey of shipping finance research: Setting the future research agenda' (2018) *Transportation Research Part E: Logistics and Transportation Review*, Volume 115, 164-212.

has historically been explained by the more readily available nature of bank loans and the capital intensive nature of the industry which requires assets of high commercial value.¹⁰ Shipping loans were also granted on the basis of relationship banking, based on good faith, familiarity, disclosure and trust between the shipping company and the bank.¹¹ The Poseidon Principles therefore has real potential to renew this tradition of good banking relationships, including a set of environmental ideals. This marks an important convergence of objectives between actors to tackle global environmental challenges. However, this convergence of objectives needs to transform from an early normative concept to an enforceable loan-agreement term with adequate weighting in order to bring about the intended change in the long term.

1) Green Financing for Shipping and Directions for Poseidon Principles

'Green Finance' is a concept defined by the International Trade Centre as 'all the initiatives taken by private and public agents (e.g. businesses, banks, governments, international organizations, etc.) in developing, promoting, implementing and supporting projects with sustainable impacts through financial instruments'.¹² Although environmental concerns were first noted by the World Bank fifty years ago, green financing is an embryonic market and has mainly served land-based renewable energy projects.¹³ In respect of shipping, green financing products have consisted most notably of Germany's KfW's scrubber projects and the European Investment Banks (EIB) collaboration with ING for their green shipping facility.¹⁴ The EIB Green Shipping Finance Facility falls within a greater EU framework for green financing and provides an exemplar for a set of 'green' objectives.¹⁵ The EIB has also provided a set of proforma contract terms in 2014 which provide template clauses for their

¹⁰ Ibid 165; Other important reasons have included that debt financing does not affect the ownership structure of the shipping firm which was traditionally family-orientated with concentrated ownership, and that raising funds through obtaining bank loans does not require public disclosure of inside information, unlike in IPOs and corporate bond issues, see Manolis G Kavussanos & Dimitris A Tsouknidis, 'Default risk drivers in shipping bank loans' (2016) *Transportation Research Part E: Logistics and Transportation Review*, Volume 94, 71-94.

¹¹ Ibid; Mitroussi et al 'Performance drivers of shipping loans: An empirical investigation' (2016) *International Journal of Production Economics*, Volume 171, Part 3, 438-452.

¹² ITC 'What is Green Finance?' <http://www.intracen.org/What-is-green-finance/> accessed 15 November 2019.

¹³ Department for Transport (UK) *Clean Maritime Plan* July 2019.

¹⁴ EIB (2018) Netherlands: ING and EIB provide EUR 300m to finance green shipping <https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping> accessed 29 August 2019.

¹⁵ An analysis of this scheme in context has elucidated the importance of a clear and directional framework for green financing projects, see Jason Chuah, 'Legal Aspects of Green Shipping Finance – Insights from the European Investment Bank's Schemes' in Mukherjee P et al. (eds) *Maritime Law in Motion. WMU Studies in Maritime Affairs*, vol 8. (2020 Springer, Cham).

green financing and financial support agreements.¹⁶ This document sets out, inter alia, the environmental obligations expected by the EIB for Borrowers and includes the undertaking to: (i) implement and operate the project in compliance with Environmental Law, (ii) obtain and maintain requisite Environmental Approvals for the project, and (iii) comply with any such Environmental Approvals.¹⁷ The environmental standard imposed on borrowers thus seems to be one dependant on applicable national and EU law. This has led to criticisms of the scheme as being ‘too demanding’ on users by imposing too many requirements.¹⁸ Furthermore, shipowners/promoters are already expected to be well-established and to have significant experience and necessary competences to gain access to the works which fall within the programme.¹⁹ This factor, as well as the administrative complexity of the programmes, would mean that many shipowners are ineligible for EIB support.²⁰

The EIB Green Shipping Finance Facility, although pioneering in addressing green shipping, illustrates that too many requirements too soon can have the unintended effect of locking certain Shipowners out of the market instead of assisting them to make the ‘green leap’. Private Banks have the advantage of greater flexibility in imposing a set of standards and should therefore more gradually tighten standards and requirements until such a time the industry is well-versed in the ‘language’ of the Poseidon Principles Framework. This Article argues for a steady but incremental phasing in of Poseidon Principles clauses into loan agreements. The normative groundwork must be laid before Shipowners are overburdened with too many contractual obligations that could result in hardship. On the other hand, if contractual mechanisms are non-existent or lacking in enforcement power, the Poseidon Principles could face criticism of whether Signatories really are committed to environmental governance standards.²¹

Essentially, the collective problem that must be addressed is finding ways to increase access to finance for innovative new-builds and the rapid uptake of green technology installations on

¹⁶ EIB, *EIB template contractual clauses on environmental matters* (December 2014) https://www.eib.org/attachments/documents/eib_standard_contractual_clauses_on_environmental_information_en.pdf accessed 21 January 2020.

¹⁷ Ibid clause 1(a).

¹⁸ Monitor Deloitte, ‘EU Shipping Competitiveness Study: International benchmark analysis’, Study commissioned by the European Community Shipowners’ Associations (February 2017).

¹⁹ Ibid 46.

²⁰ Ibid; Other criticisms include that the EIB Transport Lending Policy focuses heavily on supporting inland water transport, ports and logistics, whilst only providing funding to vessels flying an EU state flag.

²¹ Marie-Anne Moussalli and Ioanna Tsekoura, ‘The Poseidon Principles – Part 1 – Overview’ (Clyde & Co 24 February 2020) https://www.clydeco.com/insight/article/the-poseidon-principles-part-1-overview?utm_source=vuture&utm_medium=email&utm_campaign=poseidon%20principles%20update%20-%20part%201 accessed 28 February 2020.

existing vessels. The negative externalities of green shipping and inadequate dissemination of technological and economic data have meant that green technologies are not considered good returns on investment and are therefore unable to attract finance at competitive rates. This presents a significant barrier to the uptake of green technologies which require strong incentivisation schemes with clear policy frameworks. The Poseidon Principles provides a workable solution for addressing this gap and providing clear policy guidance on green financing. Although the IMO provides a global mandate, the Poseidon Principles can provide a sectoral-specific set of objectives for financiers with shipping portfolios. Even if the Poseidon Principles start out as merely aspirational values with normative effect, this would still amount to a step in the right direction. However, a long-term view would envision increased application of the Poseidon Principles framework to loan agreements with legal effect and remedy.

The Poseidon Principles framework is aligned with the IMO's long-term goal of reducing the shipping industry's total emissions by at least 50 percent from 2008 levels by 2050. The Poseidon Principles provide signatory banks with an industry-specific methodology for assessing and disclosing the climate impact of their shipping portfolios. Four key principles apply to lenders, relevant lessors and financial guarantors including export credit agencies. These principles must be applied in all business activities that are credit secured and where the vessel falls under the regulatory standards of the IMO. The four principles are as follows:²²

- Assessment of climate alignment: Signatories will measure the carbon intensity and assess the climate alignment of their shipping portfolios on an annual basis
- Accountability: Signatories will rely on Classification Societies and IMO-recognised Organisations for data and information sources
- Enforcement: Signatories will use standardised covenant clauses in contracts with clients to ensure access to high-quality data
- Transparency: Climate alignment scores will be published annually meaning that signatories will make their status public knowledge

Although the standard covenant clause clearly imposes duties on the Owner of a vessel to uphold certain calculating, reporting and disclosure standards (for which technical guidance and options are given), there seems to be no apparent guidance on the consequences of non-compliance or what contractual remedies should be available to Lenders if a Shipowner fails to carry out its Poseidon duties. Perhaps this is to give Lenders more flexibility in their approaches at the early stages of implementing the Framework. Increased application of the

²² See *Poseidon Principles: A global framework for responsible ship finance* <https://www.poseidonprinciples.org/download/Poseidon_Principles.pdf> accessed 16 November 2019.

abovementioned principles would see the expansion of enforcement remedies available to the Lender in the event of non-compliance and a number of terms included other than the suggested SCC. The following section evaluates ways to include environmental considerations in loan agreements as a way to evaluate how the Poseidon Principles can permeate these contractual relationships for clear future directions.

2) Loan Covenants and the Environment

Bank loan covenants generally require specified performance by borrowers or consist of restrictions, such as limitations on entering new debt agreements, regulatory compliance, maintaining certain governance and management structures, or various financial reporting requirements.²³ More recently, covenants in loan agreements have become an important tool in a bank's environmental risk management. Environmental risks generally have three aspects: credit risk, lender liability and reputational risk.²⁴ Credit risk is influenced by the growing body of restrictive environmental regulations imposed on borrowing companies which weakens their position to repay loans, whilst security offered in the form of real property²⁵ can mean impaired value of collateral and saleability if non-compliance occurs.²⁶ Lender liability is directly linked to the bank's own governing environmental legislation which can result in costly rehabilitation, clean-ups and damages caused by the bank's borrowing companies. Reputation risk refers to the public's perception of the bank, as well as by its key stakeholders who significantly contribute to the long-term viability of the institution.²⁷

To control and monitor such risk, banks have incorporated environmental covenants into their loan agreements since the seventies.²⁸ Initially, these took a broad form whereby a general clause was inserted into an agreement to ensure the borrower's commitment to the green objectives of the project and to carry out the financed project with due diligence in accordance with best practice.²⁹ These covenants were most notably used in agreements for World Bank development projects, based on the Articles of Agreement of the Bank which required the

²³ Peter Illingworth, 'Ship Finance – the Bankers Perspective', in Stephenson Harwood, *Shipping Finance: A Practical Handbook* (Globe and Law Business 2018)

²⁴ Yinshuo Xu et al, 'The Impacts of Environmental Risks on Bank Loan Covenants and the Cost of Bank Loans: an Australian Case Study and the Implications for China' in *Proceedings of the 2018 International Conference on E-Business and Applications* (ICEBA 2018). Association for Computing Machinery, New York, NY, USA, 36–40.

²⁵ For example, contaminated land in respect of terrestrial activities or a vessel which can only use HFO's.

²⁶ Phil Case, *Environmental risk management and corporate lending: a global perspective* (1999 Woodhead Publishing Limited, Cambridge).

²⁷ Smith et al, 'Does brand management of corporate reputation translate into higher market value?' (2010) *Journal of Strategic Marketing*, 18(3), 201- 221.

²⁸ Ibrahim F. Shihata, 'The World Bank and the Environment: a Legal Perspective', (1992) 16 *Md. J. Int'l L.* 1.

²⁹ *Ibid.*

Bank to ensure that financing is strictly used for the purposes for which it was provided, taking into account considerations of economy and efficiency.³⁰ However, environmental covenants with a more general nature, such as the one included in the World Bank's set of General Conditions, were based on ambiguous standards and did not provide much in the way of legal remedy. They were resultantly viewed as 'soft obligations' or non-binding guidelines without providing the Bank with adequate recourse if environmental issues were dealt with improperly during project implementation. These general covenants were therefore essentially helpless when environmental impacts were not anticipated. It became clear that specific environmental covenants which were well-defined and imposed clear duties, were necessary.

Specific environmental covenants, which now form common part of industry practice, are ordinarily aimed at environmental risk exposure with a consistent view that the environmental covenant comprises a promise by the borrower to undertake or avoid certain environmental-related activities.³¹ These covenants typically involve:

- Compliance with prevailing environmental legislation, regulations or standards;³² and
- Periodic reporting to the bank regarding the borrower's environmental performance and management.³³

Unprecedented climate change awareness and public concern, has meant that banks are exposed to increased risk where they fail to adequately report on climate change risk or do not adhere to strict environmental standards. Various legal techniques have been employed to ensure compliance and reporting with environmental standards. These include:

Conditions Precedent: A set of pre-conditions and requirements which must be satisfied as a conditionality upon which disbursement of the proceeds of the loan is contingent.³⁴ These may include proof of certain valid permits, certificates or government-requested documents. They may also include corrective actions plans and mitigation measures. In shipping loan agreements, condition precedents would ordinarily relate to the security

³⁰ A suggested covenant was introduced upon the suggestion Ibrahim F. Shihata in 1984 to ensure a convergence of objectives between borrower and Bank where the Bank 'plays the role of a supportive Financier'.

³¹ Mohammed A Bekhechi, 'Some observations regarding environmental covenants and conditionalities in World Bank lending activities' in Av Bogdandy & R Wolfrum (eds), *Max Planck yearbook of United Nations law*, (1999 Kluwer Law International Ltd, Leiden, 3, 287-314).

³² Ibid 301.

³³ Yinshuo Xu et al (n24).

³⁴ Stefan Otto & Thilo Scholl, 'Legal Treatment of Ship Finance Loans: Analysis of the Ship Loan Contract' in Orestis Schinas, Carsten Grau, Max Johns. (eds) *HSBA Handbook on Ship Finance* (2015 Springer, Berlin, Heidelberg).

of the parties, the vessel and legal opinions.³⁵ This would include various vessel certificates, constitutional documents of the borrower and any corporate guarantor, copies of any charterparty of the vessel, the memorandum of agreement by which the borrower agrees to buy the vessel.

Representation and Warranties: A series of statements of fact on the basis of which the parties enter into the agreement. Loan agreements will often contain a warranty that the financier has been furnished with a full set of complete and accurate documents pertaining to the purchase of the specified property and that relevant environmental laws have been complied with. However, in the context of shipping loan agreements, representations and warranties specifically relating to the vessel may also be included in the in the mortgage, or in the mortgage only.³⁶

Covenants/Undertakings: These include actions to be taken by the borrower and may include compliance with prevailing environmental laws and standards, reporting on environmental performance, or notification of environmental accidents and incidents of non-compliance. Positive covenants in shipping loan agreements have traditionally included the responsibilities of the borrower to, inter alia, comply with the terms and conditions of their financial obligations, to register the ship in a ship register acceptable to the lender and to provide any information in the event of default.³⁷ Negative covenants are also considered a form of undertaking, these require the borrower to refrain from taking certain actions. In shipping loans, these generally include obligations not to encumber any assets with a liens, transfer or dispose of the vessel, of enter into any further agreements relating to the operation or chartering of a vessel.³⁸

Event of Default: Most loan agreements contain a comprehensive list of events that upon occurrence, would entitle the financial institution to cancel the transaction and declare the outstanding balance of the loan as well as accrued interest repayable. It is important that these clauses make clear that it is not the event itself that accelerates the loan, but the financial institution's declaration or notice - this is to avoid the borrower pleading limitation as a defence in future litigation whereby the financier claims the outstanding

³⁵ Dora Mace-Kokota & Danaë Hosek-Ugolini, 'The Financing of Second-Hand Vessels' in Stephenson Harwood, *Shipping Finance: A Practical Handbook* (Globe and Law Business 2018).

³⁶ Julie Clegg, 'The Ship Mortgage – Introduction' in Stephenson Harwood, *Shipping Finance: A Practical Handbook* (Globe and Law Business 2018)

³⁷ Stefan Otto & Thilo Scholl, 'Legal Treatment of Ship Finance Loans: Analysis of the Ship Loan Contract' (n34) 64.

³⁸ Ibid.

amounts.³⁹ In shipping loans, the most common events of default include if the vessel is sold or encumbered, registration of the ship or the mortgage is challenged, the vessel becomes a loss and the loan is not repaid within the agreed period.⁴⁰

These techniques are rooted in and understanding of English law of contract whereby terms of a contract can be classified as either conditions, warranties or intermediate/innominate terms.⁴¹ These distinctions are important insofar as determining what remedies are available to aggrieved parties in disputes. It follows logically that the stronger the obligation, the stronger the remedy. A condition is any term that is said to 'go to the root of' a contract.⁴² The breach of a condition entitles the aggrieved party to either repudiate the contract (i.e. to be released from performance) and claim for damages for any losses, or to uphold/maintain the contract and claim for damages. A warranty, on the other hand, is a statement or promise that a current or future condition is true. The breach of a warranty only entitles the aggrieved party to damages.⁴³

Intermediate or innominate terms are a third category of terms, the breach of which may result in damages only or termination of the entire contract.⁴⁴ Whether a party may reasonably repudiate a contract based on a breach of an intermediate term should be determined by whether the occurrence of the breach deprived the aggrieved party 'substantially of the whole benefit' which would be obtained under the contract.⁴⁵ The uncertainty about the remedies available following the breach of intermediate terms can be solved by the use of an express termination right in a contract. It must be noted however, that an express termination clause will not transform an intermediate term into a condition.⁴⁶ Furthermore, exercising the express termination right under a contract will not deprive an innocent party of the common law remedies available where there has been a repudiatory breach.⁴⁷ It therefore follows that where the aggrieved party has exercised a termination right, but there was no repudiatory breach, then certain common law remedies such as compensation for loss of a bargain will not be available unless agreed to as a contractual damage in the contract.⁴⁸

³⁹ Dora Mace-Kokota, Danaë Hosek-Ugolini, 'The Financing of Second-Hand Vessels' (n 35) 98.

⁴⁰ *Ibid.*

⁴¹ For more on contractual terms, see Paul S Davies & and JC Smith, *JC Smith's the Law of Contract*. Oxford University Press, Oxford, 2018.

⁴² *Poussard v Spiers and Pond* (1876) 1 QBD 410

⁴³ *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 904 (HL)

⁴⁴ *Hong Kong Fir Shipping Co. Ltd. v Kawasaki Kisen Kaisha Ltd.*, [1961] 2 Lloyd's Rep 478 (CA)

⁴⁵ *Ibid* 495.

⁴⁶ *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2016] EWCA civ 982, [2016] 2 Lloyd's Rep 447.

⁴⁷ *Ibid*

⁴⁸ *Ibid.*

Covenants are distinct from conditions and warranties and could be classed as one such innominate term. It is unusual to find the term “covenant” in English contract law literature, whereas in American literature it is more clearly defined. This is because a covenant is essentially an express undertaking for future action or inaction and does not really permit its own species of term under English Law. It seems similar to a warranty in that it is a promise of a future condition, however, if the covenant is material enough it could afford more than compensatory damages and may give rise to a right of termination. Other remedies could also include injunctive relief or specific performance.

Similarly, the term “default” is not a clearly defined legal term in English law. In respect of ship mortgages, “default” is generally construed as including any failure to abide by the contract on the part of the shipowner.⁴⁹ More commonly in modern commercial practice, “default” now applies within a loan agreement context to those defined ‘events of default’ in a facility agreement.⁵⁰ Covenant defaults will occur when the mortgagor or borrower breaches one of the undertakings specified in the relevant agreement, after which a default will occur if the shipowner has not remedied the default within a stipulated time period.⁵¹ Loan agreements, as well as ship mortgage documentation, is drafted to expressly provide that upon occurrence of an event of default, the mortgagee’s rights become exercisable or the Lender is entitled to legal remedy.

Because most covenants and events of default are expressly worded in loan agreements, it is unnecessary to require a breach of covenant to be material or repudiatory in order for the non-breaching party to be afforded adequate remedy. The English law classification of loan agreement clauses into conditions, warranties and innominate terms therefore may have little relevance to the Lender’s enforcement rights.⁵² However, it is expressly because of this understanding of how contractual terms are interpreted, that it is extremely rare to find a situation where a Lender/Mortgagee is entitled to repudiate a contract without an express event of default having occurred on which the Lender/Mortgagee could also rely to exercise its rights. On the other hand, the Borrower would not be able to challenge a Lender’s reliance on an express event of default to repudiate a contract on the grounds that the breach merely

⁴⁹ *Doe ex dem. Gertrude Baroness Dacre v Mary Jane Roper Dowager Lady Dacre* 126 ER 887 (CCP), (1798) 1 Bos & P 250, 258.

⁵⁰ David Osborne, Graeme Bowtle, and Charles Buss. *The Law of Ship Mortgages* (Informa law from Routledge, Milton Park 2017) 221.

⁵¹ *Ibid* 223.

⁵² *Ibid* 226, where the same argument is applied to a mortgagee’s enforcement rights in the event of default.

amounted to a breach of warranty and not a breach of condition or an innominate term of a serious nature. Therefore, courts are never faced with situations where they have to apply discretion in assessing the seriousness or materiality of an event of default in order to accelerate and enforce remedies, including taking possession of the ship if it is mortgaged and selling it to enforce the mortgage.⁵³

However, the Privy Council did somewhat assess the merits of certain events of default in respect of granting the Borrower/Mortgagor relief against forfeiture in *Cukurova Finance Ltd v Alfa Telecom Ltd*.⁵⁴ In this case, Alfa Telecom Turkey Ltd (Alfa) concluded a loan agreement with a company in the Cukurova group. The loan was secured by charges over Cukurova's shares in a number of BVI companies. In April 2007, Alfa contended that various events of default had occurred and accelerated the loan and demanded immediate payment of the outstanding balance. Cukurova was unable to pay the amount and as a result, Alfa appropriated the shares. The following month, Cukurova notified Alfa that it intended to "prepay" the full amount and attempted to provide the full sum eight days later. Alfa rejected the payment on the basis that it was too late and attempted to gain control of the company whose shares it has appropriated as security.

The series of events leading up to Alfa's acceleration of the loan and appropriation of the shares included arbitration proceedings which were instituted against Cukurova in Geneva for the enforcement of a pre-emptive agreement with a third company called Telia Sonera Finland OYJ (Sonera). These proceedings resulted in an award being granted to Sonera, which then issued a press release announcing that the Geneva arbitration had 'resulted in an award which (i) concluded that there was a binding obligation on Cukurova to transfer its holding in another company to Sonera for \$3.1m, and (ii) ordered specific performance of that obligation'.⁵⁵ Alfa argued that this award would have "material adverse effect on the financial condition, assets or business" of the Cukurova and therefore amounted to an event of default under the loan agreement. It also alleged that sixteen other events of default had occurred. The Privy Council assessed the merits of these events of default in order to grant Cukurova relief from forfeiture. The Privy Council found that 'the Award, giving rise to an event of default relating to 'material adverse effect', involved a decision on a strongly contested issue' and Alfa was kept fully aware of this claim.⁵⁶ Furthermore, the other events of default relied on by Alfa, 'even if they had all been established, demonstrate no bad faith' on the part of the Cukurova Group and

⁵³ Ibid 217, 226.

⁵⁴ *Cukurova Finance International Ltd & Anor v Alfa Telecom Turkey Ltd (British Virgin Islands)* [2013] UKPC 2 (30 January 2013).

⁵⁵ Ibid 22.

⁵⁶ Ibid 125.

'caused no significant damage' to Alfa'.⁵⁷

Although the facts of this case were complicated, the Privy Council essentially considered issues of "serious damage" and "good faith" in determining that the mere occurrence of an event of default, will not necessarily result in the range of remedies afforded by the loan agreement, namely the enforcement of a mortgage and appropriation of security. The relevance this has for environmental covenants might be that claims against the Borrower for violations of environmental standards, could not be as clear cut as initially thought. Where such a claim against the Borrower results in an event of default for breach of an environmental covenant, the Lender might have to provide evidence that it has been prejudiced and damaged by the covenant violation. Where the claim is contentious and any awards are subject to appeal, the Lender could argue that mere affiliation with the environmental violation is damaging to its reputation and social and environmental image.

As a useful example, the Equator Principles (EPs) have provided useful guidance for the Equator Principles Financial Institutions (EPFIs) in incorporating environmental and social considerations into loan documentation.⁵⁸ Guidance is given to EPFIs on how to apply the EPs for four financial products: Project Finance Advisory Services, Project Finance, Project-Related Corporate Loans, and Bridge Loans.⁵⁹ The Guidance states that although it is not a requirement to include the EPs Action Plan as an Annex in any loan agreement, the loan agreement should contain reference to this plan. The Guidance also states the inclusion of environmental and social provisions will largely depend on context, but it suggests a number of ways to include these clauses in the key components of a loan agreement. The Guidance then goes on to provide template clauses for every aspect of the loan agreement, with a heavy emphasis on reporting and monitoring. For example, as a condition precedent to all disbursements, the Borrower has to furnish the Lender with a certificate certifying that the Project is operational and complies with all environmental requirements, as well as a completeness status for the actions referenced in the Principles Action Plan. There are also lengthy reporting requirements, including the furnishing of progress reports, operational reports and public reporting for Projects emitting over 100,000 tonnes of CO₂ equivalent annually. Many of these reporting requirements should be included to varying extents in the Loan Agreement's conditions precedent, warranties and covenants. Events of Default include any non-compliance with or breach of environmental or social covenants, as well as any proof

⁵⁷ Ibid 125.

⁵⁸ Equator Principles, Guidance Note https://equator-principles.com/wp-content/uploads/2017/03/ep_guidance_for_epfis_on_loan_documentation_march_2014.pdf accessed 24 February 2020.

⁵⁹ As defined in the *Equator Principles – June 2013*.

that a representation or warranty was incorrect or misleading. Claims brought against the borrower which could reasonably be expected to result in ‘Material Adverse Effect’ on the implementation or operation of the project in accordance with applicable requirements is also considered an Event of Default under the EPs contractual guidance.

It is not submitted that shipping loans should involve these kinds of burdensome reporting standards. The EPs apply to project financing, which will often occur within the jurisdictional boundaries of a state. There are therefore a number of national, provincial and municipal standards and regulations which will require countless permits and authorisations depending on the environmental management framework in which the Borrower’s project finds itself. However, the EP Guidance on loan agreements adopts a “belts and braces” approach to the attainment of its environmental objectives, which can provide useful guidance to institutions applying the Poseidon Principles. It incorporates environmental and social clauses into all key areas of the loan agreement, which take the form of conditions, warranties, representations and covenants – the breaches of which are *also* addressed under events of default. The Lender can therefore rely on common law principles for breaches of various terms if it is alleged that an event of default has not resulted in “significant damage” to the Lender or is based on a “contentious” matter, as seen in the *Cukurova Finance Ltd v Alfa Telecom Ltd* case.

It is also important to note that terms can be ‘implied’, although the vast majority of terms will be expressed in the contract itself. Terms can be implied as a matter of fact, whereby an ‘officious bystander’ test determines that certain things are ‘so obvious that it goes without saying’.⁶⁰ Therefore adherence to the Poseidon Principles framework and compliance with environmental standards could also be implied into loan agreements if not expressly stated. However, it remains far more satisfactory to provide express provisions for the sake clarity and clear allocation of obligations. There is also an argument to be made that an overarching ‘green principle’ or the Poseidon Principles objectives can be implied as a matter of law. Here, the courts will have regard to duties which *prima facie* occur in certain types of contracts, as guided by matter of policy and reasonableness.⁶¹ Although the courts have not yet dealt with the emergence of ‘green obligations’ in loan agreements, there is the potential for environmental rights to become more pervasive in private relationships as the climate change agenda is afforded priority status in public law regimes. Similarly, such terms could become customary in loan agreements and many environmental lawyers would argue for the elevation of an environmental duty to become tantamount to the principle of good faith. These novel

⁶⁰ *Shirlaw v Southern Foundries (1926) Ltd* [1939] 2 KB 2016.

⁶¹ These terms are generally seen in employment contracts or contracts for the supply of goods or services, see *Ashmore v Corporation of Llyod’s (No2)* [1992] 2 Lloyds Rep 620.

propositions and their legal exposition could make for interesting research beyond the scope of this paper.

3) Poseidon Principles Standard Covenant Clause:

The current Standard Covenant Clause (hereafter SCC) for relevant vessel financing documents between Signatories and Borrowers (namely shipowners), makes direct reference to Annex VI of MARPOL and mandates compliance with Regulation 22A for Collection and reporting of ship fuel oil consumption data for a ship's SEEMP. The SCC Reads as follows:

Covenant Clause: The [Owner] shall, upon the request of [any Lender] and at the cost of the [Owner], on or before [31st July] in each calendar year, supply or procure the supply to [the Facility Agent] [such Lender] of all information necessary in order for [any Lender] to comply with its obligations under the Poseidon Principles in respect of the preceding year, including, without limitation, all ship fuel oil consumption data required to be collected and reported in accordance with Regulation 22A of Annex VI and any Statement of Compliance, in each case relating to the [Vessel] for the preceding calendar year 3 [provided always that [no Lender] shall publicly disclose such information with the identity of the [Vessel] without the prior written consent of the [Owner]/[.For the avoidance of doubt, such information shall be ["Confidential Information"] ["Information"] for the purposes of [Clause [•]] (Confidential Information)] [Section [•]] (Treatment of Certain Information; Confidentiality)] but the [Owner] acknowledges that, in accordance with the Poseidon Principles, such information will form part of the information published regarding the [relevant] [Lender's] portfolio climate alignment.

It is worth noting that merely because a clause claims to be a covenant, it does not necessarily mean that it is one within the legal understanding of the nature of the term. As the Poseidon Principles SCC requires an undertaking to disclose information at a future date(s) it seems to fall squarely within the understanding of an environmental covenant which requires the positive action of periodic reporting. However, as far as providing Signatories with guidance on how to effectively incorporate enforcement mechanisms into their contracts, this suggestion is somewhat open-ended. Furthermore, the Poseidon Principles website states that the covenant is "recommended" but not "compulsory" for Signatories without stating that an equivalent clause or term should be included.

The Technical Guidance on Accountability and enforcement provides no further information

other than stating that ‘Signatories will agree to work with Clients and Partners to covenant the provision of necessary information to calculate carbon intensity and carbon alignment’.⁶² The Poseidon Principles’ information flow process relies on accurate data evidencing that shipowners are in compliance with the IMO’s Fuel Data Collection System (IMO DCS) and have obtained a Statement of Compliance from a recognised organisation (RO). An RO includes classification societies or an authorised organisation that performs statutory requirements on behalf of the flag state of a vessel.

In respect of accountability, a number of steps are included in the technical guidance. These include:⁶³

Step 1: Sourcing vessel IMO DCS data

Step 2: Calculating vessel carbon intensity and climate alignment

Step 3: Calculating climate alignment of portfolio

Step 4: Disclosure

The preferred source of information for an information flow at each step is a ‘recognised organisation’. The only exception is the disclosure step, which serves as a quality control mechanism. Here, the information will remain internal and will be submitted to the Secretariat for the purposes of informing the actions of the Steering Committee, and will not be publicly disseminated.⁶⁴ It is therefore assumed that the SCC incorporates all these steps when it covenants that the Owner shall ‘supply or procure the supply to the Lender, all information necessary in order for the Lender to comply with its obligations under the Poseidon Principles’. As the SCC does not specifically lay out these obligations, technical guidance should really include that these obligations be included in the Definitions section of the Loan Agreement or as an Annex.

Currently, no guidance is given as to what remedies should be available in the event of a breach of the SCC. From a contractual standpoint, there is no argument that this covenant clause ‘goes to the heart of the contract’, for which non-compliance would afford the right to repudiation.⁶⁵ Mere non-compliance with the requisite periodic reporting would not deprive the Lender ‘substantially of the whole benefit’ of the contract either.⁶⁶ The remedy remains

⁶² Poseidon Principles, Technical Guidance on Accountability and Enforcement, <www.poseidonprinciples.org/download/Poseidon%20Principles_Technical%20guidance_Enforcement.pdf> accessed 28 February 2020.

⁶³ Ibid 5.

⁶⁴ Ibid 32.

⁶⁵ *Poussard v Spiers and Pond* (1876) 1 QBD 410.

⁶⁶ *Hong Kong Fir Shipping Co. Ltd. v Kawasaki Kisen Kaisha Ltd.*, [1961] 2 Lloyd’s Rep 478 (CA)

somewhat unclear in the absence of an 'Event of Default' provision. It would therefore be more prudent for the Technical Guidance to include that breach of the SCC should be listed as an event of default under the loan agreement. However, as illustrated by the *Cukurova Finance* case, the Lender may still be unable to accelerate the loan or enforce a mortgage merely because the event of default has occurred, especially where the event of default is contingent on a contentious issue or causes no obvious damage to the Lender. A Borrower could argue that failure to comply with the SCC has not prejudiced the Lender in any way, caused any tangible damage or adversely affected its ability to repay the loan.

If the SCC were the only enforcement mechanism included by Signatories in their loan agreements, the Lender would in all likelihood have limited remedies in the event of breach. The Lender could seek an injunction to enforce the reporting standards but the quantification of damages would be a difficult task.⁶⁷ In order for the Lender to claim damages for the breach of covenant, it would need to either claim damages in the conventional way, showing that it has lost profit or incurred additional expenses;⁶⁸ or illustrate that negotiating damages can be awarded where, 'the loss suffered by the claimant is appropriately measured by reference to the economic value of the right which has been breached or considered an asset' and 'the breach of the contract results in the loss of a valuable asset created or protected by the right which was infringed'.⁶⁹ However, it would be a stretch to claim that the term 'valuable asset' could be extended to reputational rights. The 'valuable assets' here are essentially proprietary right or rights such as intellectual property and rights of confidence.⁷⁰ A Signatory would have a difficult time trying to argue that its green image is tantamount to a right which is lost through the breach of the contract unless the law is extended in this way.

'Stigma damages' have in fact been considered by the House of Lords in respect of an employee's contractual damages as a result of the breach of an implied term.⁷¹ In the case of *Malik v BCCI* it was held that a bank owed an implied obligation to its employees not to conduct a 'dishonest or corrupt business'.⁷² Employees of the bank were therefore able to sue for loss of reputation as a contractual breach, despite the fact that no parallel claim existed in Tort Law as the bank had not made any defamatory statements regarding the employees. However, it was crucial that this loss of reputation resulted in actual loss as the employees would struggle

⁶⁷ See *Priyanka Shipping Limited v Glory Bulk Carriers Pte Limited* ("The Lory") [2019] EWHC 2804 (Comm) where an injunction and damages were claimed in respect of breach of an undertaking.

⁶⁸ *Morris-Garner and another v One Step (Support) Ltd* [2018] UKSC 20 95(1) – (9).

⁶⁹ *Ibid* 95(10).

⁷⁰ *Priyanka Shipping Limited v Glory Bulk Carriers Pte Limited* (n58) 193.

⁷¹ *Malik v. Bank of Credit and Mahmud v. Bank of Credit SA* [1997] UKHL.

⁷² *Ibid*

to gain future employment due to their affiliation with the bank and the bank's breach of contractual duty. Lord Steyn interpreted previous case law to find authority that a party can claim 'stigma damages', where there is a breach of a contractual term (even an implied one), actual pecuniary loss is suffered by the claimant, the loss was caused as a result of the breach, and the loss is not too remote.⁷³ Therefore a Poseidon Principles institution would have limited remedy in the way of damages where the breach of the SCC results in reputational loss only with no tangible financial consequences. Stigma damages are also usually confined to employment disputes and their application to other aspects of banking relationships is yet to be seen.

Although the *Malik v BCCI* case would not be helpful to Signatory banks of the Poseidon Principles where no actual loss stems from the breach of covenant which impugned the bank's reputation, it provides useful authority for implying a duty into the contract. Here a term of mutual trust and confidence for the bank to not 'without reasonable and proper cause, conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of confidence and trust between employer and employee'.⁷⁴ This term could be implied by law as an incident of all contracts of employment.⁷⁵ Similarly, a duty could be implied into loan agreements, especially those where the banking institution in question has strongly committed itself to an environmental objective. Where the SCC is the only safeguard to enforce the Bank's rights against the Borrower for non-compliance with its environmental requirements, then the Bank could argue that a duty to 'promote responsible environmental stewardship throughout the global maritime value chain' is implied into the contract due to the nature of the agreement as a shipping finance loan. As its shipping portfolio adheres to the Poseidon Principles Framework, it can be implied into all its contracts that the objectives of the framework must be met and any failure to do so or any action which compromises this could result in breach of contract.

Despite the possibility of such an implied term, the SCC still offers limited remedy to the Bank where non-compliance occurs - especially where no pecuniary loss is proven. In order to strengthen remedies against the Borrower/Shipowner and limit exposure of the Bank to Lender Liability and Reputational Risk, Signatories could explore a number of contractual options to include the Poseidon Principles more extensively in their loan agreements. The ferociousness of climate change litigation is unlikely to lose momentum and financial

⁷³ *Ibid* 535.

⁷⁴ *Ibid* 531.

⁷⁵ *Scally v Southern Health and Social Services Board (British Medical Association, third party)* [1991] 4 All ER 563 at 572.

institutions are increasingly being held accountable for the environmental projects which they have provided capital for.⁷⁶

4) Conclusions: Future Directions for Poseidon Principles in Loan Agreements

As the Poseidon Principles are seen as having increased normative value for Signatories, whilst providing increased ways of attaining finance for Shipowners, it is inevitable that the Principles will more strongly permeate the set of obligations imposed on parties. A long-term outcome will involve the inclusion of the Poseidon Principles objectives into every key aspect of the loan agreement. This article calls for a phased approach to strengthening the legal effect of the Poseidon Principles Framework. As seen with the EIB Green Shipping Finance Facility, too many requirements at an early stage can have the unintended effect of being too cumbersome and administratively impractical. Many of these criticisms have previously been directed at the IMO for implementing tightening standards without adequate guidance or due consideration to practical implications.⁷⁷ The current economic climate calls for quick access to capital without too much red tape to meet a set of urgent targets.

As an initial way to implement the normative guidance of the Poseidon Principles, the Definitions and Interpretation section of a loan agreement should include an explanation of the Poseidon Principles framework in which the agreement takes place. Definitions should be provided for, inter alia, the “Assessment of climate alignment”, the IMO and MARPOL, “carbon intensity”, and “information flows”. As most loan agreements usually contain a section named “The loan and its purpose”, this section should outline clear co-operation and the alignment of objectives between the Lender and Borrower to achieve joint environmental commitments. The Poseidon Principles objectives should also be included in this section with clear reference to the purposes of this loan for the “financing of greener shipping”. Although these introductory statements run the risk of being viewed as mere soft obligations,⁷⁸ they will not have the deterrent effect of imposing too heavy a burden on Shipowners. At the same time, and especially in the event of grievous non-compliance, a Signatory can still rely on legal

⁷⁶ Javier Solana, ‘Climate Litigation in Financial Markets: A Typology’, *Transnational Environmental Law*, 1-33.

⁷⁷ For example, the 2020 Sulphur Cap Requirement has been met with much criticism as the availability of low-sulphur fuels, the costs of scrubbers, and the lack of technical guidance on compliance and enforcement have been raised by industry actors. See E Den Boer & M Hoen (2015). *Scrubbers - An Economic and Ecological Assessment*. Delft; PISR (2019) IMO 2020 Sulphur Regulation I Your Opinion Matters: Interim Survey Findings 2019 < <https://www.palareg.com/wp-content/uploads/2019/10/Palau-International-Ship-Registry-Survey-Report-2019.pdf> > accessed 13 November 2019.

⁷⁸ As noted in a previous discussion of the World Bank’s early use of environmental covenants (n30).

arguments that a set of environmental objectives go to the heart of the contract or can even argue for the breach of an implied term, if environmental obligations are not explicitly stated beyond the purview of the “Purpose” section.

As part of an intermediate phase in the evolution of loan agreements, Conditions Precedent should include all ship fuel oil consumption data required to be collected and reported in accordance with Regulation 22A of Annex VI and a Statement of Compliance. If the financing is for a new-build vessel, then design documents evidencing that the ship will meet regulatory standards and agreed targets should be included under conditions precedent. A Poseidon Principles action plan for increased environmental performance and carbon neutrality could also be included as a condition precedent for the obtainment of the loan.

As seen with the Equator Principle loan agreements, the Borrower can warrant that it has produced to the Lender all relevant reports and information on environmental matters, and that this information has been confirmed by a recognised organisation or independent consultant. A possible warranty could also include that the vessel is compliant with prevailing international, regional and state laws under which the vessel shall operate as evidenced by an Opinion, issued by counsel and acceptable to the Lender. In addition to the recommended Poseidon Principles SCC, negative covenants could also be included to the effect that the Borrower will not violate any prevailing environmental standards at various regulatory scales. Furthermore, that the Borrower shall not partake in any activities which may impugn upon the “green reputation” of the Lender and bring into question the environmental integrity of the Lender’s shipping portfolio.

Finally, ‘events of default’ clauses could provide enhanced remedy if any of the aforementioned condition precedents, warranties or covenants are breached. Contractual remedies could also be listed in the contract, to which both parties agree and cannot be disputed. By including contractual terms of all natures into the loan agreement, the Borrower cannot question the materiality of the Poseidon Principles obligation on both parties. The Lender will be able to rely upon a number of breaches, as recognised in the common law, as well as those which are listed as events of default. The SCC, as it currently stands, leaves much room for contractual innovation and the incorporation of normative values. This is an exercise of utmost importance for a balanced and achievable implementation of increasing environmental objectives.

It also goes without saying that incentivisation for greener performance on the part of shipping firms should not stem solely from the fear of disputes, arbitration, litigation, and the heavy

costs of a resultant award. Although adequate enforcement of the loan agreement's environmental provisions is one vital component of the incentive scheme, Banks could strengthen their commitment to environmental sustainability by linking pricing to a ship's carbon efficiency. Whether Signatories are willing to make less profit to ensure that they adhere to environmental and governance standards remains to be seen, however a convergence of objectives might negate such comparisons or a polarisation of commercial and environmental factors.⁷⁹ The costs of environmental non-compliance, climate change litigation and reputational risk means that adhering to a green framework can significantly benefit all parties to a loan agreement.

⁷⁹ Scepticism about the Poseidon Principles being a mere Public Relations exercise have been voiced; see Marie-Anne Moussalli and Ioanna Tsekoura, *The Poseidon Principles – Part 1 – Overview* (24 Jan 2020 Clyde & Co) < https://www.clydeco.com/insight/article/the-poseidon-principles-part-1-overview?utm_source=vuture&utm_medium=email&utm_campaign=poseidon%20principles%20update%20-%20part%201> accessed 29 February 2020.

The City Law School
City, University of London
Northampton Square
London EC1V 0HB

T: +44(0)20 7040 3309
E: law@city.ac.uk



Email enquiries:
law@city.ac.uk



Telephone enquiries Find out more, visit
+44 (0) 44 02 7040 5787 www.city.ac.uk/law

