

A GREENER VOYAGE: FIT FOR 55

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INTRODUCTION

"The 'Fit for 55' package proposes a basket of EU measures to increase the contribution of maritime transport to EU climate efforts, along with measures agreed at a global level with the IMO."

As we reported in our previous **article**, in December 2019, as part of the European Green Deal, the European Council recommended "*extend[ing] European emissions trading to the maritime sector*". One year later, it called on the Commission to make the 'necessary proposals'. On 14 July 2021, despite objections from various stakeholders, the Commission confirmed that from 2023 emissions from maritime transport should be included in the existing European Emissions Trading Scheme (ETS). The proposals are intended to be part of a wider legislative package which the Commission has coined 'Fit for 55'.

The 'Fit for 55' package proposes a basket of EU measures to increase the contribution of maritime transport to EU climate efforts, along with measures agreed at a global level with the IMO. Besides the extension of the EU ETS to maritime transport, the basket of measures notably contains the FuelEU Maritime

initiative, which aims to increase the demand and deployment of renewable alternative transport fuels, as well as a proposal to review the Energy Taxation Directive with regard to the current exemption of fuel used by ships from taxation. This article focusses on the proposals made regarding the extension of the EU ETS to maritime.

THE EU ETS

The proposals for the EU ETS to extend to maritime transport are as extensive as expected¹. It is anticipated that the legislation, once negotiated and agreed with the European Parliament, is to be implemented through a directive (the "Directive") and, to this end, the Commission has prepared a draft. Member States will be required to achieve the objectives and implement the measures into their national legal systems in time for the anticipated 2023 start date.

The key points to note are as follows:

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- The EU ETS will apply to ships over 5,000 gross tons in respect of their emissions from intra-EU voyages, half their emissions from extra-EU voyages (where the start or end of the voyage occurs at a port in a Member State) and emissions occurring at berth in an EU port arising from voyages to load or unload cargo or passengers (i.e. those ships already subject to the EU Monitoring, Reporting and Verification Regulation²);
- The same rules that apply to other sectors should apply with regard to auctioning, the transfer, surrender and cancellation of allowances, penalties and registries;
- The obligation to surrender allowances in the maritime transport sector is to be gradually phased in over the period 2023 to 2025 on an incremental basis, with shipping companies having to surrender 20% in 2023, rising to 100% of their verified

emissions as of 2026. The cap on emissions for the sector will be based on EU MRV data from 2018 and 2019, adjusted for 2021. In accordance with the phase-in, to the extent fewer allowances are surrendered in respect of verified emissions during those years, the amount of allowances not surrendered should be cancelled;

- "Shipping Company" is defined as the shipowner or any other organisation or person, such as the ship manager or the bareboat charterer, that has assumed responsibility for the operation of the ship from the shipowner and that, on assuming such responsibility, has agreed to take over all the duties and responsibilities imposed by the International Management Code for the Safe Operation of Ships and for Pollution Prevention, set out in Annex I to Regulation (EC) No 336/2006 of the European Parliament and the Council;
- It is currently proposed that 79 million allowances will be allocated for maritime transport. The exact date of this allocation has not been confirmed. The proposals only permit shipping companies to purchase credits allocated specifically to the maritime sector. There will be no free allocation of allowances;
- Whether there will be scope for trading is unclear. We anticipate that further information will be published at a later date with regard to trading. What is clear, however, is that participants will be able to buy allowances in advance of the start of the scheme ('frontloading') but will not be allowed to purchase international credits;
- In addition to the general EU ETS rules on penalties, expulsion orders can be issued against ships under the responsibility of a Shipping Company that has failed to surrender allowances for two or more consecutive reporting periods, with the result that ships under its responsibility can be detained by the flag Member State and denied entry into a port under the jurisdiction of a Member State other than the flag state. The proposals ensure that the expanded EU ETS scheme will 'name and shame' non-compliant operators with the publication of the names of Shipping Companies who are in breach of requirements to surrender sufficient allowances under the scheme;
- Thus, any Shipping Company that does not surrender sufficient allowances by 30 April of each year to cover its emissions during the preceding year will be liable to payment of an excess emissions penalty of €100 for each tonne of carbon dioxide equivalent emitted for which the operator has not surrendered allowances;
- Each Shipping Company falling within the scope of application of the EU ETS is attributed to a Member State – the administering authority – for its administration under the Directive. The administering authority is determined based on where the Shipping Company is registered. If the company is not registered in a Member State, it is attributed to the Member State where it had the highest number of port calls in the two previous monitoring years;
- As of 2024, the Commission is to publish and regularly update a list of Shipping Companies covered by the Directive and their respective administering authority; and

- A reporting and review clause will be included in the Directive to monitor the implementation of the above and to take account of relevant developments at the level of the IMO with the potential to introduce global market-based mechanisms in 2028.

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CONCLUSION

These proposals will need to be adopted by the European Parliament and the EU Council before they become effective. Timescales may slip as the Commission is likely to face intense lobbying by the maritime industry. This may involve some negotiation between the legislative bodies as they must reach a common agreement. Nevertheless, these changes should be expected during 2023 and preparation must be made by those Shipping Companies that will be affected. This will not only include Shipping Companies who are registered in a Member State but will also extend to those Shipping Companies registered outside the EU conducting voyages for ships over 5,000 gross tonnage to and from EU ports.

As set out in our previous briefing, long term charters are already being drafted to anticipate proposals for future fuel levies, carbon taxes, and global emissions trading schemes³. Greater challenge awaits shorter charters in terms of who bears

responsibility. There is also a growing risk that Shipping Companies will have to comply with multiple emissions trading schemes if UK, China and other countries decide to subject maritime emissions to similar cap and trade mechanisms. We continue to recommend that parties at least consider the following "action points" when drafting and negotiating their contracts:

- Given the broad definition of Shipping Companies as the party responsible for surrendering allowances, parties should expressly state in their contracts who is responsible for obtaining allowances under an ETS. This would usually be the party with operational control of the vessel that is responsible for the choice of fuel, route and speed of the ship (e.g. the charterer);
- Given the ultimate sanction of the expulsion of ships, we recommend that group company structures are reviewed together with MRV ship data in order to map compliance going forward such that compliance between group entities is kept separate to avoid piercing the corporate veil to the extent possible;
- Any allocation of responsibility would need to be carefully drafted and agreed to ensure absolute clarity on the transfer and assumption of responsibility for ETS compliance;
- Consider whether there would be any advantage in 'frontloading' allowances when they become available for sale;
- Consider also whether existing and new contracts should not only ensure clear allocation of responsibility for ETS but also any fluctuations in carbon price which at present moment is circa €50 but could either increase or decrease as the 2030 emissions reduction target approach;
- Consider taking legal advice to understand the scale of the reporting, how best to pass on a portion of costs onto customers and what contractual arrangements and protection should be negotiated early on;
- Engage external consultants to calculate how many allowances you are likely to need to purchase on an incremental basis in the period 2023 – 2026 in order to price the increase in costs of compliance; and

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- Parties should remember that the EU ETS may well constitute a further environmental law with which owners must comply, not just to avoid fines and expulsion orders, but to comply with financing arrangements that require undertakings that all environmental laws are followed.
- There is currently some uncertainty regarding potential liability and exposure of financiers in the event of the Shipping Company going insolvent and whether liability would fall on the financiers. Further clarity should be sought from the Commission on this potential risk such that this question is properly addressed in the course of lobbying and next round of amendments to the proposals, both for maritime ETS and FuelEU Maritime.

Shipping Companies, particularly those whose administering bodies are based outside the EU, will likely face increased administrative and compliance costs once the proposals are enacted. It remains to be seen what form the enactments will take when the final text of the EU ETS is published. Certainly, any opportunity to lobby the Commission either directly or via trade associations should be maximised now in order to secure as flexible and workable a scheme for maritime as possible.

[1] For more information, see our article [<https://www.wfw.com/articles/a-greener-voyage-navigating-emissions-trading-schemes-for-the-maritime-sector/>]

[2] Regulation (EU) 2015/757 (as amended by Delegated Regulation 2016/2071)

[3] For more information, see our briefing “MI and SI proposed carbon tax: contractual considerations, available here

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