

The EU Emission Trading System; are you ready?

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Marine insurer Gard has provided a long and detailed guide to the history and schedule of the EU Emission Trading System (ETS).

Louis Shepherd Senior Claims Adviser, Lawyer, London, noted that the 2005-launched ETS works as a “cap and trade” scheme where emitters of CO2 in certain sectors have to purchase allowances to cover their carbon emissions during the relevant trading period. The number of allowances at any one time are fixed, but they generally reduce each year, so that emissions within the EU also fall.

How the scheme will be applied to shipping has been under discussion for some time, but Shepherd said that “there now seems to be agreement between the European Parliament, the Council of Ministers and the European Commission that the key features will be:

- Application to all vessels over 5,000 GT trading within EU waters, irrespective of flag
- Start date of 1 January 2024 (pushed back from 1 January 2023)
- A phased-in implementation, with 40% of emissions covered by the system during 2024, 70% for 2025 and 100% for 2026.
- All intra-EU voyage emissions to be covered by the scheme
- 50% of EU in-bound/out-bound voyage emissions will be covered
- The ‘shipping company’ (defined as owner, manager or bareboat charterer) will be responsible for surrendering the allowances
- The system will cover carbon dioxide, methane and nitrous oxide
- 30 April deadline for surrender of allowances for the previous calendar year -for example, 30 April 2025 deadline for 2024 emissions
- Non-compliance can lead to penalties and expulsion orders

However, several parts of the scheme are still unclear, and questions have been raised about two particular areas relating to shipping.

First, in the Special Rapporteur’s report of 24 January 2022, it says that where a ship is on charter and the owner is not responsible for purchasing fuel or making decisions about the vessel’s speed, cargo or route, then:

“... a binding clause should be included in such arrangements for the purpose of passing on the costs so that the entity that is ultimately responsible for the decisions affecting the CO2 emissions of the ship is held accountable for covering the compliance costs paid by the shipping company under this Directive.”

Shepherd said that , while many vessel owners would support the motivation behind this provision, it was far from clear how EU law would impose such a clause in private contractual arrangements between parties that may not be based in EU states.

A second area of discussion was how emissions on voyages into or out of the EU would be determined, and if operators may seek to evade the full application of the EU ETS.

Shepherd warned that operating vessels under an ETS was a completely new situation for vessel owners and time charterers, “so the learning curve will be steep”.

BIMCO has an ETS– Emission Trading Scheme Allowances Clause for TimeCharter Parties 2022. Under the clause, the charterer is responsible for purchasing and transferring to the owners the allowances to cover the vessel's actual emissions used in ETS areas while on hire. The clause also covers other issues, such as sharing data to enable compliance with an ETS, reconciliation between the allowances and actual consumption at the end of a charter and giving the owners a right to suspend.

The BIMCO clause has been drafted to apply to any scheme around the world, and to cover any greenhouse gas that may be subject to a scheme, not just carbon.

However, Shepherd noted that, under most time charterparties, the vessel owner does what they can to reduce their credit risk to the charterer. To avoid allowances being transferred in arrears, owners could require the charterer to transfer enough allowances up front to cover the bunker fuel to be used under the ETS, to be topped up as/when the vessel receives new fuel. “If so, the BIMCO clause would need to be amended”.

It was noted that these issues were unlikely to be relevant in the context of voyage charters, where the owner would generally be responsible for supplying the fuel, and hence the cost of any allowances that arise from using it. Owners who voyage charter would therefore need to build something into their freight/demurrage rates for ETS costs.

The costs of ETS allowances might be relevant under some consecutive voyage charterers if they have clauses to adjust freight rates depending on bunker prices – for example, if bunkers are sold inclusive of allowance costs, or as ETS allowance prices change.

Gard said that, now that the EU's emission trading system had been agreed, vessel owners and charterers that may trade within the EU should ensure they are prepared to comply with its requirements in 2024. Preparation will include setting up contractual arrangements to suit their needs, for which the BIMCO ETS clause is a good starting point.

<https://www.gard.no/web/articles?documentId=34594894>