REBECCA BAX: THE EU EMISSIONS TRADING SYSTEM (ETS) – CONTRACTUAL CONSIDERATIONS FOR OWNERS AND OPERATORS

SHIPOWNERS

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INTRODUCTION

The Club previously prepared an article on the EU Emissions Trading System (ETS) and the inclusion of the maritime industry in this scheme.

With the EU ETS in force as of 1 January 2024 and shipping companies being required to surrender their first ETS allowances by 30 September 2025 for emissions reported in 2024, this article will further set out who is responsible for compliance with the EU ETS, the associated costs and contractual considerations for both owners and operators.

WHO IS RESPONSIBLE FOR COMPLIANCE WITH THE EU ETS?

The EU ETS states that the "Shipping Company" is the entity responsible for compliance with the EU ETS. The "Shipping Company" is defined within the EU ETS as "*the shipowner or any other organisation or person, such as the manager or the bareboat charterer, that has assumed responsibility for the operation of the ship from the ship owner 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*"[1].

It has now been clarified that, by default, the registered shipowner will be considered responsible for compliance with EU ETS obligations. However, the EU ETS does permit an ISM Company to contractually agree to assume responsibility for EU ETS obligations. The ISM Company is a party who has assumed responsibility for the Document of Compliance (DOC) under the ISM Code and would ordinarily be a bareboat charterer or technical manager.

The Implementing Regulation[2], which was published in November 2023, clarified what is required for this responsibility to be validly transferred. For there to be a valid transfer of responsibility the ISM Company must provide the administering authority responsible with a mandate document that demonstrates the existence of an agreement according to which the ISM Company is mandated by the registered owner to comply with EU ETS obligations. The Implementing Regulation has no set format for this mandate document, however it specifies that it must be signed by both parties, list the date of the transfer and the date of the information, the vessels covered by the mandate agreement, and must contain basic corporate information on the shipowner and the mandated entity. It may be that evidence of an agreement between an owner and a bareboat charterer in a charterparty, or between an owner and a technical manager in a management agreement, may be sufficient if it contains the required information. We would however recommend that more comprehensive agreements or clauses are drafted to clearly set out the obligations on the parties, the remedies available to the owner for non-compliance by the ISM Company, and how and when the mandatory agreement can be terminated.

The Implementing Regulation does not provide answers to all scenarios and does not cater for a situation where a bareboat charterer has a dual-flag registration or where they want to re-delegate the responsibility to their own technical manager. It remains to be seen how these scenarios will work in practice and, for the

[1] Article 31 of Directive (EU) 2023/959

[2] Implementing Regulation (EU) 2023/2599 of 22 November 2023

latter, it may be that clauses must be inserted into the bareboat charter which require the registered owner to delegate authority to the specified technical manager.

WHO IS RESPONSIBLE FOR THE COSTS OF EU ETS COMPLIANCE?

Whilst overriding responsibility for EU ETS compliance and surrender of allowances (EUAs) rests with the Shipping Company, the EU ETS does make provision for the costs associated with compliance with the EU ETS to be transferred from the Shipping Company to another entity where that entity holds ultimate responsibility for "*the purchase of the fuel, or the operation of the ship*"[3]. This is defined as determining the cargo carried or the route or the speed of the ship and, by this definition, it is expected that time charterers will qualify as a responsible third party and voyage charterers may qualify, depending on the terms of the relevant contract.

BIMCO's ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022 (ETSA Clause) was introduced to provide a mechanism for the costs associated with EU ETS compliance to be passed to the time charterers under the "polluter pays" principle. Under the ETSA Clause, the parties are required to co-operate and exchange all relevant data in a "timely manner" to enable the parties to calculate the amount of "Emission Allowances" that must be surrendered[4]. The owner remains responsible for monitoring and reporting the ship's emissions to an independent verifier[5], with the charterer then required to provide and pay for the Emission Allowances throughout the charterparty period. The owner is required to notify the charterer in writing of the quantity of Emission Allowances within the first seven days of each month, and no later than fourteen days before the expected redelivery for the estimated final month[6], with the charterer then required to transfer the Emission Allowances within seven days[7]. If the Emission Allowances calculation for the final month is higher or lower than the actual quantity calculated by owners at the time and date of delivery, any difference is required to be transferred to the relevant party within seven days of written notification.

The ETSA Clause specifies that for periods of off-hire, which are not defined within the ETSA Clause and so will be in line with the off-hire clause within the charterparty, the owner is responsible for emissions from bunkers during that period[8]. This mirrors the position under a conventional time charterparty in relation to bunkers and, whilst ordinarily the bunkers are paid for and provided by the charterer, during periods of off hire the owner is required to reimburse a charterer for any bunkers consumed.

We see immediate benefits in the emissions data being calculated monthly for both the owner and charterer. A charterer will be able to carefully monitor the impact of the voyage orders they are giving and the associated costs throughout the life of the charterparty, being able to plan their fixtures accordingly. For an owner, this model ensures that they will have received the relevant Emissions Allowances from a charterer well in advance of the date at which they are required to surrender the EUAs to the relevant authority. Where a charterer fails to remit any of the required Emission Allowances, the ETSA Clause provides the owner with the right to, subject to a five-day notice period, suspend performance of any or all of their obligations under the charterparty until such time as the Emission Allowances are received in full[9]. This is an important safety net for the owner, who remains ultimately responsible for compliance with no direct risk of fines falling upon the charterer, and allows the owner to exercise commercial leverage against the charterer. The ETSA Clause does not specifically address whether an owner will be able to exercise a lien over cargoes and sub-freight

[3] Article 3gc, Directive 2003/87/EC

[4] Clause (a) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022
[5] Clause (b) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022
[6] Clause (c)(i)(1) and (c)(i)(2) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022
[7] Clause c(iii) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022
[8] Clause c(iv) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022
[9] Clause (d) ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022

for unpaid Emissions Allowances and so whilst they may be considered as "any amount due"[10], the parties may wish to make amendments to the lien clause within the charterparty to directly address this point.

The ETSA Clause does not address who is responsible for the costs of verification of the ship's emission data and therefore it may be that, as the verification is the owner's responsibility, they will bear the costs. With emissions required to be submitted monthly and with currently only a limited number of approved verifiers, who can set the costs of verification, we can envision that the costs of verification may escalate quickly and may be a cost that the owner wishes to pass on. It may be that we therefore see an expansion of the ETSA Clause to address this point with the parties either splitting the costs, or the charterer being solely liable.

Finally, the ETSA Clause defines "Emission Allowances" as an "*allowance, credit, quota, permit or equivalent, representing a right of a vessel to emit a specified quantity of greenhouse gas emissions recognised by the Emission Scheme*"[11]. The BIMCO explanatory notes state that this refers to an allowance issued by an authority under a "cap and trade" system, meaning that the charterer is to transfer the actual EUAs themselves, rather than a cash equivalent or reimbursing the owner. The basis of this decision is to avoid complications with price fluctuations. We do however envision that, if an owner wishes to increase their cash flow throughout a charter, then they may elect to receive cash in lieu of the EUAs. There does of course then come a risk of price fluctuations and it will need to be clearly specified how the monetary value will be calculated, but this does give an owner freedom to decide when to purchase the allowance in any given year and they can potentially take advantage of price fluctuations in the EUAs markets and potential benefits of purchasing in bulk.

CONSEQUENCES OF NON-COMPLIANCE

Where a Shipping Company fails to surrender sufficient EUAs, they will be liable to pay an excess emissions penalty set at EUR 100 for each tonne of carbon dioxide equivalent emitted for which the operator has not surrendered allowances, plus they are still liable for the surrender of the required allowances.[12] In addition, the names of Shipping Companies which are non-compliant are disclosed to the public by the Member States. The publication of non-compliant Shipping Companies could become a powerful deterrent as it may be that vessels that fall under the responsibility of a named Shipping Company could be a less attractive option to a charterer, affecting the daily hire rate that can be achieved.

If a Shipping Company fails to surrender the required allowances for two or more years in a row, a Member State of an EU port of entry can issue an expulsion order to any vessel under the control of the Shipping Company, with that expulsion order remaining in place until the Shipping Company fulfils its surrender obligations. Where a vessel enters the port of its flag state, the Member State may detain the ship until the company fulfils its obligations. This could have far reaching implications as where the Shipping Company is the technical manager, and where that technical manager has management for vessels owned by different registered owners, unrelated owners could theoretically find their ships not permitted to enter ports or detained for the failure of an unrelated vessel to comply with its EU ETS obligations. An owner will wish to carefully consider their contracts with technical managers to ensure that, if their vessel were to be subject to an expulsion or detention order due to EU ETS non-compliance by an unrelated vessel, there is a right of recovery against the technical managers for the associated losses.

As advised, the ultimate responsibility for surrender of EUAs remains with the Shipping Company, the registered owner, regardless of who is responsible for meeting the cost of compliance with the EU ETS. Despite the remedies available to an owner under the ETSA Clause, an owner could then find themselves in a position where a charterer has failed to surrender the required EUAs. In such a situation a prudent owner may wish to take steps to acquire the EUAs themselves, mitigating the risk of fines or detention, and then

[10] Clause 23 of NYPE 2015

[11] Guidance Notes - Definitions - https://www.bimco.org/contracts-and-clauses/bimco-clauses/current/etsa_clause

[12] Article 16, Directive 2003/87/EC

seek to recover the cost from the charterer. However, as a belt and braces approach, an owner may consider whether it is possible to place responsibility for any consequential losses due to the expulsion or detention of a vessel onto the charterer.

CONCLUSION

The inclusion of the maritime sector in the EU ETS will have far-reaching implications and parties will be required to carefully consider how contracts need to be adapted to account for the monitoring and surrender obligations. The BIMCO ETSA Clause provides a clear starting point for how an owner and charterer can look to allocate costs for EU ETS compliance, however we anticipate that parties will look to adapt or expand this clause to meet their specific commercial needs. The Club remains on hand to advise and assist our Members who may wish to consider incorporating relevant clauses into their contracts.