

Circular From North

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Navigating Decarbonisation: Understanding the EU-ETS

The European Union's carbon trading scheme is expected to include shipping from 2023.

The EU's Emissions Trading Scheme (EU-ETS) is the world's largest carbon-trading scheme and operates in all EU countries and Iceland, Liechtenstein, and Norway. Starting in 2005, the scheme focused on the power sector and manufacturing industry. But **in 2019, the European Commission (EC) announced its new European Green Deal which confirmed the inclusion of maritime transport into the EU-ETS.**

On 14 July 2021, the European Commission set out a package of proposals, including its proposal in respect of the EU-ETS, which provides for the inclusion of shipping under the EU-ETS from 2023. The scheme is expected to apply to emissions from vessels 5,000GT and greater performing voyages with the purpose of transporting passengers or cargo for commercial purposes and includes ballast voyages.

The scheme applies to emissions as follows:

- half of the emissions from ships performing voyages arriving at an EU port from a non-EU port
- half of the emissions from ships performing voyages departing from an EU port and arriving at a non-EU port
- emissions from ships performing voyages between EU ports
- emissions at berth in an EU port

Carbon trading

The EU-ETS works on the 'cap and trade' principle. A cap is set on the total amount of greenhouse gases allowed to be emitted, which is reduced over time so that total emissions fall.

Carbon credits, called 'EU Allowances' (EUA), are purchased, with some allocated for free, which can then be traded on the carbon market as needed. The limit on the total number of allowances available is controlled to ensure they have a value.

In its current form, the EU-ETS puts a price on every ton of CO₂ emitted, which is determined by the market. This is intended to act as an incentive for installations and transporters to reduce their carbon emissions, as they can sell their surplus allowances.

Every year, each emitter will surrender the required number of EUA to cover its emissions. If they have any left over, they can keep them for future use or sell them on the carbon market. A failure to surrender the required allowances can lead to heavy financial penalties and, in the event of failure to surrender sufficient allowances for two or more consecutive periods, potential expulsion from EU ports.

Under the EU plan, shipping will be added to the EU-ETS on a gradual basis from 2023, when shipowners must surrender enough EUA to cover 20% of their emissions. This is expected to rise to 45% in 2024 and 70% in 2025. From 2026, shipowners will need to surrender EUA to cover 100% of their emissions under the scheme.

Calculating emissions

The EU Monitoring, Reporting and Verification (EU-MRV) system for ships trading internationally to and from the EU is already in place and is expected to be used as the basis for calculating emissions that will fall under the EU-ETS.

Industry concerns

A number of industry bodies and countries have voiced concerns at the inclusion of shipping into the EU-ETS, primarily citing a preference for a global solution and how a regional scheme could undermine the IMO's efforts on decarbonisation as well increasing the vessel's administrative burden. To try and address this concern, a review clause has been included to ensure that the effectiveness and practical application is reviewed after a certain number of years.

Commercial risks and liabilities

Shipowners and charterers should review their contractual arrangements in good time prior to implementation of the EU-ETS to shipping.

Compliance with the EU-ETS will, in the first instance, be the responsibility of the 'shipping company', which the EU defines as "the shipowner or any other organisation or person, such as the manager or bareboat charterer, that has assumed the responsibility for the operation of the ship from the shipowner" in accordance with the ISM Code.

However, given that it will be due to the charterer's trade of the vessel that will result in the shipowner's liability under the EU-ETS, inclusion of a suitable clause in the charter party will be necessary to pass the liability down to charterers.

If shipowners wish to pass the liability down per voyage, rather than claiming at the time their liability has been verified and becomes due under the EU-ETS (by latest April of the following year), while the emissions can be calculated by reference to the EU-MRV emission equation, a mechanism will need to be included in the charter party clause to ascertain the EUA price at the relevant time.

Members with FD&D cover should approach their usual contact to discuss further.

Source of Information: The North P&I Club

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