

The EU ETS and the maritime industry

In our *Regulatory Update 2024* of earlier this year, we informed our clients about the various IMO and EU regulations that are having an impact on the shipping business. One of the main topics was the **European Union Emission Trading System** (EU ETS) because, as of 1 January 2024, the EU has extended its application to other industries within all EU and EEA Member States including the maritime sector. This latest revision of the EU ETS is part of the '**Fit for 55**' package, aiming at reducing EU's net greenhouse gas emissions by at least 55% by the year of 2030 compared to the 1990 levels and, ultimately, achieving climate neutrality in 2050. With this circular, we would like to provide our clients with a more detailed information about the application of the EU ETS to the maritime sector and the processes that are taking place in relation to ensuring compliance with it.

What is the EU ETS?

Established back in 2005, the EU ETS is the world's first emission trading system and it remains the largest one. It is a 'cap and trade' system, which puts a limit on how many greenhouse gas emissions are permitted to be released by, among others, the maritime sector (the 'cap' element). Shipping companies need to surrender EU emission allowances (EUAs) in order to compensate for the emissions already released in the atmosphere by their fleets of vessels. Those companies, who emit fewer emissions, can retain their unused EUAs for the future or else they may sell them to other shipping companies who are in need of EUAs (the 'trade' element). In this way, the EU ETS combats climate change by making polluters pay for their greenhouse gas emissions. The revenue generated by the EU ETS is intended to help finance EU's green transition.

The process of implementing the EU ETS into the maritime sector is taking place through a 3-year phase-in period (2024-2027), during which there will be a gradual implementation of the EU ETS requirements to pay for the emitted greenhouse gas emissions as follows:

- **In 2025:** 40% of the verified and reported emissions in 2024 (note: the first emission allowances must be surrendered by shipping companies by 30 September 2025 in relation to the emissions reported for 2024);
- **In 2026:** 70% of the verified and reported emissions in 2025;
- **In 2027 (and onwards):** 100% of the verified and reported emissions in the preceding year.

This phase-in period is intended to provide shipping companies and stakeholders with sufficient time to adjust economically and operationally to the new regulations. The EU ETS will thus gradually involve more stakeholders and will become more stringent. For example, its scope will include:

- **From 2024:** cargo and passenger ships $\geq 5,000$ GT regardless of their flag.
- **From 2027:** offshore ships $\geq 5,000$ GT regardless of their flag.



Furthermore, the emitted greenhouse gases that need to be accounted for by means of surrendering emission allowances under the EU ETS, include:

- **As of 2024:** carbon dioxide (CO₂) emissions; and
- **As of 2026:** methane (CH₄) emissions and nitrous oxide (N₂O) emissions. For this purpose, these two types of greenhouse gases are already included in the scope of the MRV scheme since 2024 (see below).

The application of the EU ETS is not related to the vessel's flag or the shipowner's nationality but rather to the route that a vessel is taking. Specifically, shipping companies will be accountable for the following emissions subject to the abovementioned three-year phase-in period:

- 100% of the emissions from ships travelling between EU/EEA ports;
- 100% of the emissions from ships at berth in EU/EEA ports;
- 50% of the emissions from ships travelling between an EU/EEA port and a port outside the EU/EEA or *vice versa*.

So, for example, a voyage from Singapore via Valencia to Rotterdam would require surrendering of an amount of EUAs sufficient to cover 50% of the emissions from the first leg Singapore-Valencia (as the port of origin is outside the EU) and 100% of the emissions from the second leg Valencia-Rotterdam (an intra-EU route). Considering the aforementioned phase-in period, in the year of 2025 only 40% of those verified emissions from the two legs would have to be accounted for.

In 2026, respectively, 70% of the emissions for those two legs would have to be offset by surrendering EUAs. In 2027 and beyond, 100% of the emissions for such a voyage would need to be accounted for.

When we speak of non-EU/EEA ports, one should take into account that the EU ETS currently identifies two ports differently. The neighbouring container transshipment ports of East Port Said (Egypt) and Tanger Med (Morocco) are not considered a port of call that is outside the EU/EEA in respect of containerships for the purpose of applying the EU ETS. This is to reduce the risk of evasive port calls by container vessels to ports outside the EU/EEA with the aim of circumventing full compliance. In the future, the current list with neighbouring container transshipment ports may increase depending on specific criteria.

Finally, mind that there are exemptions to the EU ETS for port calls that are for the sole purpose of dry-docking, refuelling, obtaining supplies, relieving the crew of a ship other than an offshore ship, making repairs, and for emergency reasons. For those excepted cases, EUAs need not be surrendered.

Monitoring, reporting and verification (MRV) of emissions

Monitoring, reporting and verification (MRV) of emissions is another set of obligations for shipping companies, which has been in existence already since 2018 and which is an inseparable part of the EU ETS. Under the MRV, shipping companies need to register with an administering authority and submit the necessary emissions data including a verified report for each ship

within their fleet. In particular, what is reported and submitted to the administering authority of the shipping company is the annual aggregated data. Mind that the emitted greenhouse gases are reported and verified within a certain period (reporting period), and then they are offset by the 30th of September in the following year by means of surrendering the required number of EU Emission Allowances to the administering authority.

EU Emission Allowances (EUAs)

The EU Emission allowances (EUAs) function like a licence for already emitted greenhouse gases, and they should be surrendered proportionally to the emissions. One emission allowance entitles its holder to emit one tonne of CO₂ or the equivalent amount of other greenhouse gases. Each year, the EU issues in circulation a fixed number of EUAs for the various industry sectors to which the EU ETS applies such as, as of 2024, the shipping sector. In the years to come, the quantity of emission allowances available on the market will be gradually reduced each year, which will make them scarcer and more expensive. This will serve as an incentive for shipping companies to increase fuel efficiency and use alternative fuels. Ultimately, this will contribute to the decrease in emissions.

Therefore, shipping companies must obtain EUAs by receiving or buying them in order to offset their annual emissions that have been reported and validated in the preceding year. Shipping companies may also trade with EUAs within the emission scheme where this is commercially feasible. The so acquired EUAs are then surrendered to the administering authority in order to offset the greenhouse gases that have been emitted in the previous year by the shipping company's fleet of vessels. It is not allowed to have generated more greenhouse gas emissions than what is surrendered in terms of EUAs.



How can EUAs be acquired?

EUAs can be bought on:

1. The primary market – at a fixed price through EU ETS auctions arranged by the European Energy Exchange (EEX) on behalf of the EU.
2. The secondary market – from owners of EUAs who are in excess of emission allowances. The price is fluctuating depending on supply and demand.
3. The futures market – at a fluctuating pre-determined price for a specified future delivery date.

Publicly available forecasts currently indicate that the average price of EUAs would be about EUR 95 per tonne for the period 2021-2030.

Who is responsible under the EU ETS?

Under the applicable EU legislation, it is the **shipping company** that is responsible for compliance with the EU ETS obligations. The term 'shipping company' is defined as:

- the shipowner (which is the default position), or
- any other organisation or person, such as the manager or the bareboat charterer, that has assumed the 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 (the ISM Code).

Solely holding an ISM Document of Compliance (DoC) is not sufficient evidence for such other organisation or person to be considered the shipping company under the EU ETS. Bareboat chartering alone is not considered sufficient, either. There must be clear documentation (an express agreement to transfer the EU ETS obligations) submitted to the administering authority and clearly showing that the shipowner has mandated compliance with EU ETS obligations to such other organisation or person. The EU ETS obligations can be mandated only by the shipping company and only to one single organisation or person. It should also be noted that the party responsible for EU ETS compliance is the same as the one responsible for MRV compliance.



Who is administering a shipping company?

The EU ETS is administered by the individual Member States, and a shipping company can be administered by only one Member State. The European Commission (EC) has already published a distribution list, which is publicly-available, laying down the shipping companies that perform maritime transport activities falling under the scope of the EU ETS as well as their respective administering authority in an EU/EEA Member State. This list will be updated every two years which would allow re-attributing a shipping company to another administering authority in case the latter becomes more relevant for the shipping company. A shipping company shall contact their respective administrative authority and submit the necessary information in order to open a Maritime Operator Holding Account (MOHA) in the Union Registry in the same EU/EEA country where the administrative authority is based. The Union Registry is a single EU registry operated by the European Commission (EC). It functions like an online database that holds accounts participating in the EU ETS and keeps track of the ownership of allowances held in those electronic accounts. Mind that establishing a MOHA is an important step for a shipping company in order to be able to surrender EUAs.

Attributing a shipping company to an administering authority is based on some ground rules:

- for shipping companies registered in a Member State, the administering authority in respect of a shipping company should be that Member State;
- for shipping companies registered in a third country, the administering authority in respect of a shipping company should be the Member State in which the shipping company had the greatest estimated number of port calls from voyages falling within the scope of the EU ETS in the preceding four monitoring years;
- for shipping companies which are registered in a third country and which did not perform any voyage falling within the scope of the EU ETS in the preceding four monitoring years, the administering authority in respect of a shipping company should be the Member State where a ship of the shipping company started or ended its first voyage falling within the scope of the EU ETS.

EU Member States shall ensure that the shipping companies falling under their responsibility and administration comply with the EU ETS. The compliance status of shipping companies will be determined by the administering authority based on the data available in the Union Registry. In the event of non-compliance, enforcement measures will be imposed including fines – EUR 100 of per tonne of CO₂ in addition to the allowances that are yet to be surrendered. That is, paying the fine will not extinguish the obligation to surrender the required amount of allowances. Shipping companies that are in breach will be publicly disclosed, and continuous breaches may result in refusal of entry to ships of non-compliant shipping companies (for non-EU ships), or detention (for EU ships) until that company fulfils its EU ETS obligations. This means that there may be consequences for sister ships as well in case a shipping company's fleet is not complying with its obligations under the EU ETS.

ETS clauses

The EU ETS recognises the “polluter pays” principle and provides that the shipping company should be entitled to seek reimbursement for the costs arising from the allowances and claim from any entity that is directly responsible for the decisions affecting the greenhouse emissions of the ship. Such a recovery mechanism is intended to take place under national law and/or subject to a contractual arrangement. While currently it is not clear what measures precisely EU Member States may take under their national laws, there are already certain



contractual clauses in the market which allow contractual parties to allocate the costs arising from the EU ETS. Note that irrespective of the contractual arrangements for cost re-allocation, the shipping company will remain ultimately responsible for its obligations to surrender EUAs.

The Baltic and International Maritime Council (BIMCO) has published a number of ETS clauses in order to provide the contractual parties with flexibility and different options for allocating the ETS-related costs. The clauses are drafted to operate with any applicable ETS in the future and not only with the EU ETS.

Voyage charter parties

- ETS – Emission Scheme Freight Clause for Voyage Charter Parties 2023
- ETS – Emission Scheme Surcharge Clause for Voyage Charter Parties 2023
- ETS – Emission Scheme Transfer of Allowances Clause for Voyage Charter Parties 2023

Time charter parties

- ETS – Emission Trading Scheme Allowances Clause for Time Charter Parties 2022

Ship management contracts

- ETS – Shipman Emission Trading Scheme Allowances Clause 2023

Contracts of Affreightment (COA)

- ETS – Emission Scheme Freight Clause for COAs 2024
- ETS – Emission Scheme Surcharge or Transfer of Allowances Clause for COAs 2024
- ETS – Emission Scheme Transfer of Actual Allowances Clause for COAs 2024

Conclusion

The EU ETS is now an important part of the business of every shipping company trading in the EU/EEA or calling an EU/EEA port. Therefore, we would recommend all stakeholders to carefully assess their contractual position and identify their obligations under the MRV and the EU ETS.

For more information on this topic, you could consult the website of the European Commission (EC):

- https://climate.ec.europa.eu/eu-action/transport/reducing-emissions-shipping-sector/faq-maritime-transport-eu-emissions-trading-system-ets_en
- https://climate.ec.europa.eu/eu-action/transport/reducing-emissions-shipping-sector/faq-monitoring-reporting-and-verification-maritime-transport-emissions_end_a_port_outside_the_EU_EEA_or_vice_versa

This information is meant for guidance only. Should you require more information or assistance, please feel free to contact our Loss Prevention Service Department:

LPS@msamlin.com



Ilian Djadjev

Contractual Loss Prevention Consultant

+31 10 799 5800

Ilian.Djadjev@msamlin.com

The content of this circular was prepared by MS Amlin for the addressee and for informational purposes only. It does not constitute legal advice. Nothing in this information should be interpreted as providing guidance on any question relating to policy interpretation, underwriting practice, or any other issues in insurance coverage. No warranties are made regarding the thoroughness or accuracy of the information contained in this content, and MS Amlin is not responsible for any errors or omissions. Use of it is at the user's own risk and MS Amlin expressly disclaims all liability with respect to actions taken or not taken based on any contents of it. No rights can be derived from it under any circumstances.

MS Amlin offices

Antwerp, Hamburg, London, Paris, Rotterdam and Singapore

MS Amlin | Marine

© August 2024. The information contained herein is intended to be for informational purposes only and is correct at the time of printing. This brochure is not, and is not intended to be construed as, an offering of MS Amlin securities in the United States or in any other jurisdictions where such offers may be unlawful. The services and products mentioned in this brochure may not be available in the United States or in jurisdictions where Lloyd's does not have a trading license. Potential insureds should consult with an appropriately licensed broker in their area for further information. MS Amlin Underwriting Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority under reference number 204918. Registered office The Leadenhall Building, 122 Leadenhall Street, London EC3V 4AG. Registered in England Company No. 02323018. MS Amlin Marine N.V. is registered in Belgium no. 0670.726.393. Registered address: office is Koning Albert II-laan 37, 1030, Brussels, Belgium. MS Amlin (MENA) Limited is regulated by the Dubai Financial Services Authority (DFSA). MS Amlin (MENA) Limited may only undertake the financial services activities that fall within the scope of its existing DFSA licence. MS Amlin (MENA) Limited's principal place of business in the DIFC is MS Amlin (MENA) Limited, Level 3, Precinct Building 2, Dubai International Financial Centre, Dubai, United Arab Emirates. P.O. Box 506929. This document is intended for Professional clients only as defined by the DFSA and no other person should act upon it. MS Amlin Asia Pacific Pte Limited is approved by the Monetary Authority of Singapore to underwrite on behalf of the members of Syndicate 2001 at Lloyd's. Registered in Singapore No. 200711910C Registered office 138 Market Street #03-01 CapitaGreen Singapore 048946.