



Royal Belgian
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CHARTING UNCERTAIN SEAS: LEGAL AMBIGUITIES AND COMPLIANCE STRATEGIES IN EU ETS AND FUELEU MARITIME REGULATIONS

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Abstract

This article explores the legal and operational challenges introduced by the European Union's Emissions Trading System (EU ETS) on shipping, and the FuelEU Maritime Initiative. Against the backdrop of these significant regulatory milestones, it addresses the complexities of compliance responsibilities and the legal ambiguities that contribute to uncertainty and contractual risks for shipowners, operators, and charterers. We examine standard contractual clauses aimed at mitigating these challenges, providing strategies for navigating the regulatory environment. At the same time it offers recommendations for stakeholders to achieve compliance, highlighting the critical timelines for the maritime sector's transition towards reduced greenhouse gas emissions and the adoption of renewable and low-carbon fuels.

Introduction

With the start of 2024, a new era dawned for European shipping. For the first time, ships entering Europe will have to pay for their emissions via the EU Emissions Trading System (EU ETS). Additional legislation will soon follow in early 2025, dictating what type of fuels seagoing vessels will still be allowed to use in Europe, based on the greenhouse gas intensity of those fuels. These legislative steps are part of the European Fit for 55 package, the European law that makes reaching the EU's climate goal of reducing emissions by at least 55% by 2030 a legal obligation. The EU ETS¹, effective from 1 January 2024, and the FuelEU Maritime initiative², adopted on 13 September 2023 with its provisions starting to apply from 1 January 2025, embody the EU's commitment to reducing maritime emissions and promoting sustainable shipping practices. However, in the intricate world of shipping, with numerous parties involved in the operation of a vessel, delineating responsibilities and payments will be a contractual tangle. Based on insights provided by Belgian shipowners and BIMCO, an international shipping association, this article delves into the complexities of these regulatory frameworks, focusing on the allocation of compliance responsibilities, the emergence of legal ambiguities, and the strategies stakeholders can employ to navigate these uncertain waters.

Understanding the principles of EU ETS on shipping and addressing its challenges

With the inclusion of shipping in the EU ETS, this chapter delves into the adaptation of the system for the maritime sector, starting with its main principles.

This exploration is crucial for understanding the multifaceted impact of EU ETS on shipping, from legislative interpretations that determine who bears the compliance burden to the practical challenges of implementing such regulations fleet-wide. It also scrutinizes the specific contractual and operational issues that arise, offering insights into how the maritime industry is adapting to these regulatory demands.

The principles of EU ETS

The inclusion of maritime shipping in the Emissions Trading System signals a significant shift to more accountability and environmental responsibility within the industry. This chapter explores the EU ETS framework as applied to shipping, highlighting the system's attempt to align with the "polluter pays" ethos by designating responsible entities and addressing the operational and contractual challenges that arise from this new regulatory landscape.

A 'cap-and-trade' approach

The EU ETS motivates entities to financially account for their emissions through the surrender of EU Allowances (EUAs), a key tool in controlling and diminishing greenhouse gas emissions within the EU. An EUA grants the right to emit one tonne of CO₂ equivalent

¹ DIRECTIVE (EU) 2023/959 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 10 May 2023 amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading system

² REGULATION (EU) 2023/1805 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 September 2023 on the use of renewable and low-carbon fuels in maritime transport, and amending Directive 2009/16/EC

within a certain timeframe, highlighting the system's approach to managing environmental impacts. However, there are hurdles in uniformly implementing this principle across various contexts.

Defining the responsible entity

The EU ETS legislation identifies the responsible entity as either the shipowner or another organization or person, such as the manager or the bareboat charterer, who has assumed responsibility for the operation of the ship. This definition aligns with the International Management Code for the Safe Operation of Ships and Pollution Prevention, emphasizing a broad spectrum of potential responsible parties³. The additional implementing acts⁴ further clarify the shipowner's position. Specifically, the legislation confirms the shipowner's role as the default accountable party but allows for flexibility. A mandate can transfer responsibility to the Document of Compliance (DOC) holder⁵, provided there is mutual agreement. This flexibility, however, is accompanied by the stipulation that the entity responsible for EU ETS and EU MRV (Monitoring, Reporting, and Verification) must be the same, integrating compliance efforts but also adding a layer of complexity in contractual arrangements. Initially, MRV was conducted by the DOC holder. This responsibility will now shift to the owner.

Implementation on fleet level

When assessing whether the DOC holder should assume responsibility for EU ETS compliance, it's critical to recognize that obligations are enforced on a fleet-wide basis. This means if a third-party DOC holder assumes EU ETS responsibilities for vessels from multiple owners, the entire fleet under the DOC holder's management could face sanctions if the third-party ship manager fails to meet compliance requirements. This fleet-level approach to compliance emphasises the importance of ensuring that any entity taking on EU ETS responsibilities is fully capable of meeting these obligations across all vessels under its management.

Polluter Pays Principle

The "polluter pays" principle implies that entities responsible for fuel purchases or ship operations are liable for the costs tied to the surrender of emissions allowances. Implementing this principle across EU member states, each with its unique legal framework, presents challenges, particularly regarding the reimbursement process for allowances or penalties. Adding to the complexity is the prevalent use of English law in shipping contracts, which, being outside the EU legal framework, complicates compliance to EU ETS regulations.

³ REGULATION (EC) No 336/2006 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 February 2006 on the implementation of the International Safety Management Code within the Community and repealing Council Regulation (EC) No 3051/95

⁴ Commission Implementing Regulation (EU) 2023/2599 of 22 November 2023 laying down rules for the application of Directive 2003/87/EC of the European Parliament and of the Council as regards the administration of shipping companies by administering authorities in respect of a shipping company

⁵ A DOC holder is a shipping company certified to meet international safety and environmental standards under the International Safety Management Code

Overcoming the challenges: Implementing EU ETS in maritime shipping

The implementation of the EU ETS in shipping introduces significant contractual and operational challenges, compounded by the sector's complexity and the multitude of parties involved. In what follows we zoom in on some specific contractual challenges.

Insertion of new contractual clauses

Although time or voyage charterers are not legally responsible to fulfil EU ETS obligations under public law, they often end up covering the financial costs, aligning with the "polluter pays" principle. This highlights the need for contracts to be clear and detailed. Existing and future contracts must explicitly outline how allowances EUAs are allocated, their timing, and their costs to eliminate any confusion. In managing their financial duties, charterers have two primary paths: either paying the shipowner directly or transferring EUAs to them. This necessitates thoughtful and precise contractual drafting to ensure both compliance with EU ETS regulations and the fair distribution of financial responsibilities.

The entry into force of EU ETS heralded an era of many hours of negotiation to get new clauses incorporated into both new and existing contracts. Disputes often occurred. Especially when charterers resist bearing the cost of emissions due to a lack of knowledge with the new regulation. For example in the case that non-European companies need to be familiarised with the new regulation.

When incorporating new clauses into contracts, thorough attention and negotiation are crucial to ensure that terms and conditions are mirrored in agreements involving multiple parties, such as when a ship is bareboat chartered in and then time chartered out. It's preferable to align the allocation, timing, and costs of EUAs in a back-to-back manner to minimize financial risks for the intermediary party. This method necessitates a tailored assessment of risks, taking into account the creditworthiness of customers. Adopting a stance that is both adaptable and prudent enables effective management of regulatory compliance and business risks.

BIMCO time charter and voyage charter clauses⁶ can be used as a starting point offering a contractual translation of EU ETS legislation and adhering to the implication responsibilities. However, in practice, we see that these clauses are often amended and owners and charterers negotiate case by case taking financial risks and commercial interests into account.

The implementing acts specify that the shipowner is ultimately responsible, which contrasts with the "polluter pays" principle and risks imposing costs for emissions on entities that may not be directly responsible for them. A more aligned approach could be to have the time charterer purchase fuel, potentially providing a more direct linkage between fuel consumption (and associated emissions) and the financial responsibility for emissions allowances, thus better adhering to the "polluter pays" principle.

Surrendering frequencies

In negotiations between shipowners and charterers, a common point of discussion is the frequency or timing for payment of the emission allowances. The challenge lies in the significant gap between emissions production and their surrendering date. For example,

⁶ BIMCO Emission Trading Scheme Allowances Clause for Time Charter Parties 2022; BIMCO Emission Scheme Freight Clause for Voyage Charter Parties 2023; BIMCO Emission Scheme Surcharge Clause for Voyage Charter Parties 2023; BIMCO Emission Scheme Transfer of Allowances Clause for Voyage Charter Parties 2023

emissions from 2024 only need to be surrendered in September 2025, and those from 2025 are surrendered by September 2026. This time lag puts the shipowner in a difficult position when negotiating monthly or quarterly settlements (to avoid exposure to non-compliance penalties). Charterers may refuse these settlements arguing the surrendering date is only much later in time, and thus posing a financial risk on the shipowner for contracts ending before the surrendering date.

Large oil and gas companies are, for example, already entrenched in the EU ETS for years. Some of these parties possess significant EUA reserves, and are therefore often opting against interim settlements. Preferring to view these allowances as investments, companies plan to submit them only by September. This stance can place shipowners at risk of facing substantial financial liabilities, which they are keen to avoid. To mitigate timing discrepancies, contracts may allow shipowners to procure EUAs directly if not timely received. This is hardly ideal due to the considerable expenses involved. BIMCO's emission trading scheme allowances clauses for time charter and voyage charter parties are an example of an effort to address these financial responsibilities, providing a framework for the monthly provision of allowances by charterers. However, this basis for negotiation is not straightforward - the reality often diverges, potentially impacting long-standing relationships.

Ship manager's dilemma: to assume the mandate or not

Within EU ETS the ship manager takes a special place as he can take on the responsibility for EU ETS if mandated by the shipowner.

To simplify the management of emissions allowances BIMCO's SHIPMAN Emission Trading Scheme Allowance Clause outlines three potential roles for ship managers in handling emissions allowances: (1) the shipowner takes full responsibility, (2) the shipowner retains responsibility but is assisted by the ship manager, or (3) the ship manager takes on the responsibility by signing a mandate. As a complement to the clause BIMCO works on the creation of standard form to support ship managers who opt for the mandate. This initiative comes amid expectations that the EU might not release such a form. In practice, many third-party ship managers are hesitant to accept the EU ETS mandate from shipowners, primarily because most do not have substantial financial reserves. In this context, they remain reliant on timely payments from owners to comply with the legislation. Therefore, assuming responsibility for the EU ETS poses a considerable financial risk for these firms. Additionally, the non-compliance of a ship manager may affect the vessels of other owners they represent due to the EU ETS's fleet-wide compliance requirement.

Bareboat charters: the intermediary lacking responsibility

According to the European Commission's interpretation, bareboat charterers can only take on EU ETS responsibilities if they also have the Document of Compliance (DOC) for the ship. In cases where a bareboat charterer does not hold the DOC, the legislator suggests a complex arrangement involving contractual agreements. This arrangement allows a bareboat charterer to sign a mandate with a company that manages the ship's safety (an ISM company) on behalf of the shipowner, provided the charterer has been authorized by the shipowner to perform this task. These suggested constructions, however, are criticized for being neither user-friendly nor transparent.

For bareboat charters, it is generally expected that they will bear the costs of EU ETS allowances as part of operational expenses. Given this financial responsibility, it seems

logical to also allow bareboat charterers the possibility to open a MOHA account⁷ and be acknowledged as the responsible entity under the EU ETS framework. This suggestion aligns with the "polluter pays" principle, offering a straightforward method for assigning responsibility and accountability for emissions management.

Illustrating complexity: a scenario analysis

In the scenario where a Japanese shipowner, a Belgian bareboat charterer, and a Belgian shipmanager with an existing MOHA account collaborate, two main compliance pathways emerge:

- **Mandate System Preference:** The Belgian charterer favours the mandate system due to its straightforward approach. The ship manager, operating through a Belgian entity, can be mandated to handle EU ETS compliance utilizing their existing MOHA account. This option is preferred for its simplicity and efficiency, leveraging the Belgian ship manager's expertise and established compliance framework. However, an alternative under this system permits the shipowner to select a ship manager with a non-EU entity, such as one based in Hong Kong. While this remains a viable option, it introduces greater complexity into the compliance process. This option necessitates navigating additional regulatory and logistical challenges, emphasizing the need for strategic planning and coordination to ensure adherence to EU ETS requirements effectively.
- **Alternative Approach:** If the shipmanager refuses the mandate, or cannot be mandated, the scenario becomes more complex. Here, the strategy shifts towards persuading the Japanese shipowner to open a compliance account, potentially with assistance from the ship manager. This route introduces additional administrative challenges, requiring close coordination and negotiation to ensure compliance without the direct involvement of an EU-based manager's MOHA account.

In this scenario, considering a tripartite agreement among the shipowner, bareboat charterer and the ship manager could be a strategic move to ensure clarity and shared understanding of responsibilities regarding EU ETS compliance. This agreement would serve to delineate the roles and obligations of each party explicitly, providing a structured framework for compliance and risk management. Such a contract would prevent the bareboat charterer from falling between the gaps of responsibility by establishing clear lines of communication and operational protocols among all involved parties.

Compliance, Disputes and Penalties

The complexities of liability and compliance under EU ETS raises significant questions for shipowners and charterers. BIMCO standard clauses aim to address these liability issues, particularly in multi-party arrangements, by clearly delineating responsibilities. While the EU ETS places substantial responsibility on the shipowner, the potential for charterers to default on payments poses risks. These standard clauses, however, do not currently account for penalties, focusing instead on the owner's compliance. A notable provision allows for the suspension of contracts should EUAs not be transferred timely, serving as a protective measure. Additionally, the directive's preamble hints at the "polluter pays" principle as a basis for claims, suggesting reimbursement routes for owners. Ultimately, the resolution of non-payment issues and the enforcement of

⁷ MOHA (Maritime Operator Holding Account): a specific type of account within the EU ETS framework. It is used by shipowners and ship managers, to hold and manage EU Allowances (EUAs).

compliance responsibilities necessitate negotiation, highlighting the importance of precise contractual terms, including termination clauses for non-compliance.

In managing disputes or non-compliance issues related to emissions allowances, the resolution will follow the dispute resolution framework outlined within the specific contract. BIMCO contracts revised or published after 2020 typically incorporate the Law & Arbitration Clause 2020, offering a structured approach for dispute resolution. This ensures consistency across newer contracts. For older contracts, the Dispute Resolution Clause⁸ may serve as the governing framework for resolving disputes.

The provision of a clear penalty of €100 per EUA for non-payment is a positive development to keep level playing field. This explicit deterrent contrasts with the absence of such penalties in CII⁹, highlighting the EU's proactive approach to ensuring compliance and the effectiveness of its emissions trading system. The measure strengthens environmental accountability and offers a level of enforceability that is beneficial for all stakeholders involved in reducing emissions.

Conclusion

The integration of shipping into the EU ETS poses significant challenges in defining and operationalizing the role of the responsible entity. The existing regulatory framework exposes the shipowner to several risks, such as:

- Delegating responsibility to a third-party ship manager comes with fleet-wide risk
- The challenge of amending contracts to secure reimbursements from charterers
- The complexity faced when a bareboat charterer cannot take on responsibility

While the legislation permits some flexibility in delegating responsibilities, it necessitates crafting detailed contractual agreements and grasping the financial implications. This emphasizes the need for clear, upfront agreements regarding duties and vessel specifications to avoid disputes, illustrating the careful balance needed to manage long-term contracts within the EU ETS framework successfully. As the maritime industry navigates these regulatory hurdles, the establishment of standardized clauses and contracts becomes essential for ensuring compliance and advancing the sector towards greater sustainability.

The quest for clarity about FuelEU Maritime and a call for harmonisation with EU ETS on shipping

The FuelEU Maritime Initiative¹⁰ marks an important advancement in the European Union's commitment to mitigating greenhouse gas emissions within the maritime sector. By introducing regulations that mandate the adoption of environmentally friendly fuels,

⁸ BIMCO Dispute Resolution Clause 6; BIMCO Law and Arbitration Clause 2020 Singapore; BIMCO Law and Arbitration Clause 2020 London; BIMCO Law and Arbitration Clause 2020 Hong Kong; BIMCO Law and Arbitration Clause 2020 New York; BIMCO Dispute Resolution Clause 2016 -Singapore/English Law, Singapore Arbitration; BIMCO Dispute Resolution Clause 2016 -English Law, London Arbitration.

⁹ The CII (Carbon Intensity Indicator) is a measure for a ship's energy efficiency and is given in grams of CO₂ emitted per cargo-carrying capacity and nautical mile.

¹⁰ Regulation (EU) 2023/1805 of the European Parliament and of the Council of 13 September 2023 on the use of renewable and low-carbon fuels in maritime transport, and amending Directive 2009/16/EC

the initiative sets a compliance framework for shipping entities, heralding a new era of ecological accountability.

Defining the responsible entity

Central to the FuelEU Maritime Regulation is the identification of the 'shipping company' as the principal responsible party, a definition consistent with that found in EU ETS legislation. This term encompasses not just the shipowners but also various stakeholders potentially in operational control. The legislator has further specified that only the DOC holder qualifies as the responsible entity under FuelEU, differentiating it from EU ETS where the default responsibility is placed upon the shipowner. This specific interpretation by the legislator contrasts with other international fuel regulations where ship managers act without direct financial consequences for non-compliance. The maritime industry faces challenges due to these varying interpretations, particularly affecting the implementation of MRV as this is linked to EU ETS as well. Another side effect that is not clear yet is how this interpretation will allow for 'pooling' (one of the flexibility mechanisms under FuelEU) as the shipmanager will not be the entity having control over commercial agreements that could be made under this mechanism. The sector advocates for harmonizing the "responsible entity" definition across both regulations to simplify compliance.

The maritime industry's uncertain path to FuelEU compliance

Shipping companies are currently hesitant to prepare for FuelEU due to the absence of definitive legislative texts and unclear regulatory intentions. Efforts are being made to anticipate changes by integrating broad clauses into customer contracts, yet substantial education and discussions are needed, which depend on the final legislation. Additionally, a specific BIMCO clause is not yet available, and fuel certification rules, especially for fuels produced outside the European Union, remain undefined. This uncertainty complicates industry readiness for the 2025 FuelEU implementation, challenging the notion that the industry can adapt in time without clear regulations and certification processes. The industry's ability to make billions in investments hinges on having these elements in place.

Conclusion

The FuelEU Maritime Initiative exemplifies the European Union's resolve to enhance the maritime sector's sustainability through well-defined compliance directives and specific responsibilities assigned to shipping entities. As the sector strides toward aligning with these regulatory frameworks, a nuanced examination of chartering dynamics and the intricacies of contractual duties is crucial. This context urges EU legislators to not only swiftly advance the creation of implementing and delegating acts but to also deeply engage with the maritime community. Such engagement is essential for grasping the full scope of operational and contractual impacts stemming from legislative decisions. Embracing this collaborative strategy is vital for facilitating a seamless transition towards environmentally sustainable maritime operations, ensuring that regulatory measures are pragmatically attuned to the sector's practical challenges and opportunities.

Final remarks

The incorporation of maritime shipping into the European Union's environmental regulatory landscape through initiatives like the EU ETS and FuelEU marks a pivotal moment for the industry, bringing with it a host of operational and contractual complexities. A critical area for future policy development is the potential empowerment of bareboat charterers to manage their own compliance accounts, thereby being recognized as responsible entities within the EU ETS framework. Such a modification promises to not only streamline adherence procedures but also better reflect the operational dynamics of maritime logistics. Furthermore, achieving consistency in defining the responsible entity across both the EU ETS and FuelEU directives emerges as essential. A harmonized interpretation would notably simplify the compliance journey, lessen administrative duties, and provide clear guidance for involved stakeholders, thus paving a smoother route towards achieving maritime environmental sustainability.

However, the journey towards greener maritime practices hinges not only on regulatory adjustments but also on clarifying enforcement mechanisms, particularly in relation to the 'polluter pays' principle. This is especially pertinent when shipowners or managers encounter payment defaults by the actual polluters. Both the EU ETS and FuelEU legislation demand significant effort from shipping companies in terms of contract modifications, while still leaving them exposed to financial risks should clients fail or refuse to meet their financial obligations. Addressing these challenges requires a concerted effort from Member States to ensure that the transition to environmentally sustainable shipping practices does not unduly burden those committed to leading the change. The maritime industry's capacity to adapt and align with these evolving regulations will be crucial in steering the global shipping sector towards a more sustainable and environmentally responsible future.