Shipping ETS – Charterer Liability

Analysis carried out for Transport & Environment

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Background

The European Commission have proposed adding domestic and international shipping to the EU Emissions Trading System. The proposal sets the shipowner as the responsible entity, copying the arrangement in the Council position of 25 October 2019 on the Monitoring, Reporting and Verification Regulation (MRV) revision, which is a slight change from the original 2015 MRV Regulation. As shipowners will soon have to pay for their emissions, rather than just report them as under the original MRV, there is a question as to whether the shipowner is the appropriate responsible entity going forward. Recital 20 of the proposal states:

> *The person or organisation responsible for the compliance with the EU ETS should be the shipping company, defined as the shipowner 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 … In line with the polluter pays principle, the shipping company could, by means of a contractual arrangement, hold the entity that is directly responsible for the decisions affecting the CO2 emissions of the ship accountable for the compliance costs under this Directive. This entity would normally be the entity that is responsible for the choice of fuel, route and speed of the ship.*

As stated in the recital, since ships are often leased out under charter contracts, the charterer makes decisions that affect the day-to-day emissions of the ship. This means that a large part of what determines the number of allowances, and so the ETS compliance cost, of a shipowner is in the hands of the charterer.

The language from recital 20 is reflected in the proposed amendment 3(v) where the responsible entity would be the shipowner or the bareboat charterer, on the basis of who 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, set out in Annex I to Regulation (EC) No 336/2006 of the European Parliament and of the Council*". While this on its face could move the responsible entity to being the charterer in all cases, in practice time charterers do not take on the responsibility for the Document of Compliance which would be necessary to meet this obligation. The shipowner remains the technical operator of the vessel according to the ISM Code. This therefore leaves the time charterer able to make decisions affecting the emissions of the ship, while the owner as the entity liable for surrender of allowances. The polluter pays principle is foundational to EU and wider international environmental law but with imposition of liability solely on the shipowner for ETS compliance, a gap is created between the polluter and the payer.

While the relationship between the shipowner and the charterer is a private one, the power is often on the side of the charterer, making passing along the liability through contract difficult for the shipowner. Thus, the question this analysis will address is whether the suggestion in the recital of using contract law to shift the liability can be made mandatory.

Private vs public law

EU law is largely a system of public law i.e., law governing relations between companies or individuals with state institutions. Private law sets obligations between two private parties (companies and/or individuals). The ETS is an instrument of public law in that it sets regulations between the companies that emit the regulated gases and the state institutions from which those companies must buy allowances. By requiring the charterer to accept responsibility for the compliance costs through a contractual arrangement, the EU would be imposing a private law obligation. Private law obligations are not new under EU law and the following sections will set out examples of such obligations which can be used to model a similar obligation under the ETS.

Unfair Contract Terms Directive

The purpose of the UCTD (93/13/EEC) is to harmonise national laws relating to unfair terms in contracts between a seller or supplier and a customer with a view to protecting the consumer against abuse of power by the seller or supplier. Under the UCTD contract terms are unfair if they cause significant imbalance in the parties' rights and obligations to the detriment of the consumer. Examples of such terms that are relevant to this analysis as set out in the UCTD Annex are:

- “making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realization depends on his own will alone” (Article 1(c))
- “providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded” (Article 1(l))

In both these cases the UCTD works to prevent a seller or supplier from imposing a contract term that leaves the consumer with an obligation to pay where the amount is determined by actions of the seller or supplier. This is a parallel to the shipowner and charterer, where the actions of the charterer would dictate how many allowances the shipowner will have to purchase under the ETS. Under the UCTD, EU Member States are under an obligation to ensure there is an effective means under national law for the consumer to enforce their rights and prevent the continued use of unfair terms. Consumers are also given explicit rights not to be bound by unfair terms as defined in the UCTD.

This is directly parallel to the EU ETS where the Directive requires Member States to put in place a system of penalties which are effective, proportionate and dissuasive, while the nature of the penalties is largely left to Member State discretion. The exception is in Article 16(2) of the ETS Directive which requires entities to pay an excess emissions penalty of €100 for every tonne of CO2 emitted without a corresponding surrendered allowance, in addition to buying and surrendering the correct number of allowances. The name of the non-compliant entity is also made public.

Environmental Liability Directive

Directive (2004/35/EC) works to make the polluter pays principle in articles 191 and 192(1) of the Treaty on the Functioning of the European Union operational for certain types of environmental damage. The Directive imposes strict liability for all environmental damage on entities that carry out certain types of activities (those defined in Annex III of the Directive) and fault-based liability for other types of activities. This Directive provides an example of imposing liability on the basis of the activity carried out (those in Annex III). Liability is only imposed on persons other than the operator, i.e., the owner of the relevant

land and/or assets where the operator (polluter) cannot be found. It imposes private law rights as certain groups are enabled to enforce the liability against the entity carrying out the activity and the liability cannot be excluded or reduced through a contractual arrangement.

This is directly relevant to the case of shipping where imposing the obligation on the charterer is not necessarily a preferred regulatory option as tracing the charterer could be difficult. There is no international registry of such charterers that could be consulted. Therefore, the solution would be to impose the main obligation in the legislation on the shipowner but create a private law obligation for the charterer to be liable for the costs to the shipowner. Further, the imposition of liability follows the activity (charterer) as it does under the ELD, without being concerned as to fault.

Reflecting this analysis in law

Recitals to EU laws are not legally binding. However, they can assist with interpretation where the operative provisions of the law are ambiguous. Thus, this analysis does suggest strengthening the recital language to replace "could" with "shall":

In line with the polluter pays principle, the shipping company shall ~~could~~, by means of a contractual arrangement...

However, this on its own would have no legal effect. Therefore, an addition to the operative provisions of the ETS Directive is suggested. Directives are instruments of harmonisation across the EU and so provide legislative frameworks with a core of uniformity but leave the choice of detail to the Member States. Proposal COM/2021/551 already proposes amending Article 3 of Directive 2003/87/EC (the ETS Directive) to insert a definition of "shipping company". In addition, Article 3(vi) could be inserted to provide a definition of ship commercial operator:

""ship commercial operator" means the entity who has responsibility for the operations of the ship such as the determination of the cargo carried, the route, the speed and the payment of vessel expenses such as fuel costs, port charges and canal dues, at the time the ship performs a voyage as listed in Article 3g."

The further effective provisions could be inserted anywhere in Article 3g:

"1. The ship commercial operator shall pay to the shipping company the cost of the amount of allowances matching the emissions of the ship for the duration of any contract with the shipping company on a charter basis.

2. Member States shall take the necessary measures to ensure that the shipping company has appropriate and effective means of recovering the costs referred to in paragraph 1 in accordance with Article 16 of this Directive."

This Article would then be for the shipowner to make operational via their legal advisors in negotiating any charter agreements. There is a question of how that could be done as the price fluctuates but the charterer could be made responsible for buying allowances directly or a solution could be to use an agreed price such as the highest price of allowances in the previous year. It would then be for Member States to ensure the shipowner would have the ability to find a remedy as necessary. This could be as simple as having access to courts to enforce the agreed contract, or where no ETS provision is put in a contract, the right to use the courts to insert one. Member States would need to amend their secondary law provisions on ETS penalties to bring this into force, but those provisions would have to be amended to add shipping to the ETS regardless.

Enforcement

Shipping contracts between a shipowner and charter often use England as their jurisdiction of choice. This means any dispute under the contract must be pursued in England under English law. Therefore, a question arises as to whether an EU law obligation can be enforced in England.

If the contract contains a clause stating the charterer is liable for payment of the ETS compliance cost, and the charterer has simply not paid the relevant amount to the shipowner, then the shipowner would have the right to pursue that payment under English law, the same as any other payment that was due under the contract, there would be no need to refer to EU law.

If the contract does not contain the relevant clause, enforcement could come via the requirement on the Member States in the Directive to ensure the shipowner would have the ability to find a remedy as necessary. As stated, this could be allowing shipowners to bring the charterer to court to enforce the requirement. In this instance, the fact that the contract between the two relies on English law is irrelevant, the shipowner would be bringing the charterer to court relying on the remedy in the ETS Directive. The appropriate member state to bring this action in would be the member state to which that shipowner has reporting obligations under the ETS Directive. Alternatively, if the shipowner were a company registered in an EU member state, they would have a right of action in that member state as well.

An additional deterrent effect could be the publishing of the names of charterers who do not comply with the obligation. For this an amendment of Article 16 of the Directive would be required:

"5. Member States shall ensure publication of the names of ship commercial operators who are in breach of the requirement to pay the shipping company the cost of the amount of allowances matching the emissions of the ship under Article 3g2 [Article number to be confirmed during legislative process]."

Conclusion

If the amendments as suggested here are implemented along with the rest of the ETS proposals for international shipping, there will be a closer reflection of the polluter pays principle in EU law. The shipowner will be the 'responsible entity' under the Directive, but the shipowner will also have the right to claim compliance costs from charterers and have available remedies as required.

Finally, Opportunity Green was asked four specific questions as part of this analysis which have been answered in the text and which provide a useful summary of the analysis:

1. Is there any legal impediment for the ETS Directive to include an article obliging the requirements of the Directive to be included in private contracts? **No**
2. What would the best wording be to achieve this aim? **See above suggested wording**
3. Where in the ETS proposal would such an article be best placed? **Article 3(vi) and 3g**
4. Would a strengthening of recital 20 of this amendment be sufficient? **No**