

WIKBORG | REIN

Update

May 2022

Green Shipping

**MARPOL Annex VI:
EEXI AND CII – can
your contracts cope?**

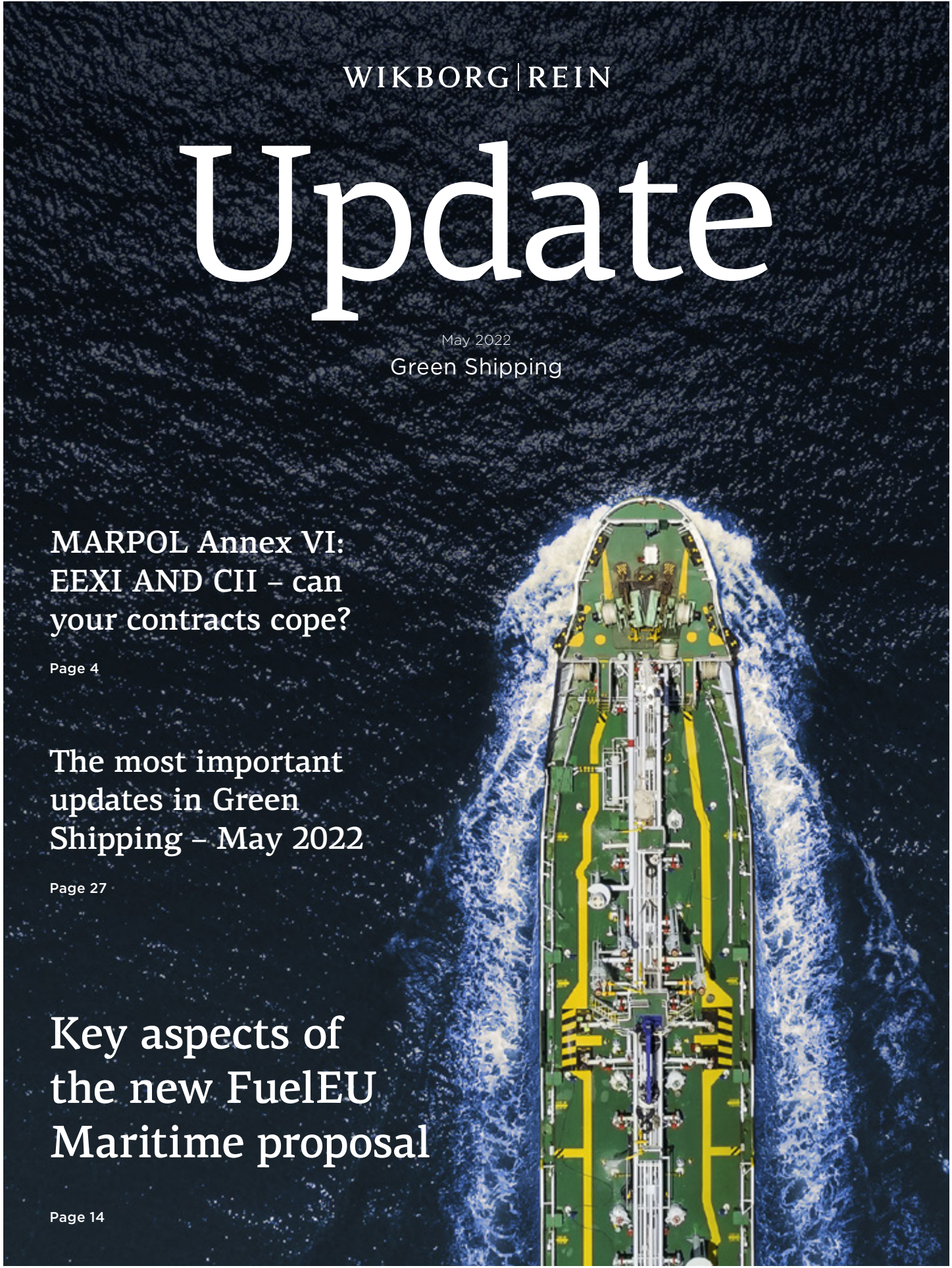
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In general, the Report entails that the EU ETS will be greener, sooner.

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Update May 2022 Green Shipping

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Dear friends and readers,

The importance of the green shift within shipping is far from a new topic. It is well established that efforts towards net zero emissions of greenhouse gases will have a profound impact on the shipping and maritime industries in the decades to come.

Although a lot of commercial and regulatory initiatives have already been implemented, we are only at the beginning of what will be a long-lasting transition involving uncertainties related to fuel types and technical solutions, international/regional regulations and changes in commercial structures. Action is needed and the transition will also provide shipowners with opportunities for value creation.

In this publication, we take a look at the most important regulations within green shipping at this point in time. IMO's regulations related to the Energy Efficiency Existing Ship Index (EEXI) and Carbon Intensity Indicator (CII) coming into force on 1 January 2023 are essential in this context. We also address important initiatives from EU forming part of their Green Deal – such as extending the scope of the Emission Trading System, adopting the EU Taxonomy and the FuelEU Maritime proposal.

Looking ahead, we consider the new initiative for “transition linked financing” for shipping companies that we hope to see used in financing transactions going forward. We also address key challenges within cross border transport of CO₂, which we believe will be an increasingly important industry interlinked with the green transition as a whole. Finally, we consider aspects of support schemes on the funding side which of course are important to make projects commercially viable.

We hope that you will find the articles in this newsletter interesting, and welcome any feedback you may have as well as your participation in our on-going discussion on green shipping.



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It is well established that efforts towards net zero emissions of greenhouse gases will have a profound impact on the shipping and maritime industries in the decades to come.

MARPOL Annex VI: EEXI AND CII

CAN YOUR CONTRACTS COPE?

Amendments to MARPOL Annex VI aimed at improving the technical and operational efficiencies of all types of ships were adopted by the IMO in June 2021. These amendments will enter into force on 1 January 2023. The amendments introduce the Energy Efficiency Existing Ship Index (EEXI), a technical measure concerned with a ship's design, and the Carbon Intensity Indicator (CII), an operational measure concerned with a ship's trading and operation.



The EEXI is a one-time requirement to improve the energy efficiency of a ship's design. The regime applies to all existing ships above 400 GT falling under MARPOL Annex VI, and will therefore cover the majority of vessels in the commercial fleet worldwide. The relevant ship will be ascribed an "attained EEXI" which will demonstrate the ship's energy efficiency compared to a baseline. The attained EEXI will then be compared to a "required EEXI" for that particular ship type. If the attained EEXI is less efficient than the required EEXI, Owners will need to take steps to ensure compliance.

IMPLEMENTATION AND COMPLIANCE WITH THE EEXI

To comply with the EEXI, a Technical File will need to be prepared for most ships (excluding those built in accordance with the already existing Energy Efficiency Design Index (EEDI) Phase 2 or 3 requirements). The Technical File will record the calculation of the attained EEXI, which must be below the required EEXI value.

Once completed, Owners or managers of a ship must submit the Technical File to its classification society for approval and also carry it on board. A verification process for the attained EEXI as recorded in the Technical File will then take place during the first annual survey in 2023, and, if verified, a new International Energy

Efficiency Certificate (IEEC) will be issued by the classification society on behalf of the relevant flag state. The IEEC will need to be presented to port authorities, though the consequences of failing to do so are not yet clear.

Whilst there are no formal requirements for Owners to make technical modifications to the ship (e.g. by installing energy saving devices or making propeller improvements), it may be the most realistic way to achieve compliance. Owners may also wish to limit engine power.

ENSURING CONTINUOUS IMPROVEMENTS TO A SHIP'S ENERGY EFFICIENCY

Where the EEXI is a one-time certification, the CII regime will ensure continuous improvements to

a ship's energy efficiency by enforcing increasingly stricter emission targets for existing ships year on year. This will apply to almost all vessels above 5,000 GT, including cargo, tankers and cruise ships.

The actual CII attained will be documented (in most cases measured in grams of CO₂ emitted per cargo-carrying capacity and nautical mile) and verified against the required CII. This gives a rating on a scale from A to E.

The attained CII should improve annually. Ships rated E, or ships which for three consecutive years are rated D, will have to submit a corrective action plan showing how the required CII will be achieved. To promote continuous improvement of attained CII for all ships, it is expected that incentives will be

There will be a heightened need to cooperate between Owners and Charterers to strike a balance between Owners' interests in adjusting to the CII regime and Charterers' interests in the vessel's employment and their obligations towards third parties.

provided by administrations, port authorities and other stakeholders to ships rated A or B.

IMPLEMENTATION AND COMPLIANCE WITH THE CII

Before the CII enters into force, all ships covered by the regulation will need to have an approved Ship Energy Efficiency Management Plan (SEEMP) in place. The SEEMP will include a plan showing how the CII targets will be achieved.

Significant reductions in a ship's CO₂ emissions can be achieved in various ways, including by slow steaming, installing and implementing new energy efficiency technologies, using alternative fuels and by operational changes (e.g. rerouting or limiting cargo intake).

IMPACT OF THE NEW REGULATIONS

The new regulations will have a profound impact across all sectors of shipping, and Owners in particular will need to act early in order to understand what measures are required to comply. This will involve reviewing existing charters and drafting future charters with the requirements acutely in mind.

There will be a heightened need to cooperate between Owners and Charterers to strike a balance between Owners' interests in adjusting to the CII regime and Charterers' interests in the vessel's employment and their obligations towards third parties.

IMPACT ON EXISTING CHARTERS

In relation to the EEXI framework, Owners and Charterers should begin negotiating their existing charters as early as possible in order to address the various challenges. If Owners intend to conform by modifying the ship, the costs of modification will most likely be for Owners' account. Owners may however wish to seek an agreement from Charterers that Charterers contribute not only with their expertise but also by covering the direct costs of modification or by accepting increased hire. The parties will also need to discuss when and how the ship should deviate to dry dock for the modification.

BIMCO's EEXI Transition Clause for Time Charter Parties 2021

On 7 December 2021, BIMCO published its EEXI Transition Clause for Time Charter Parties. The clause aims to assist Owners and Charterers under both existing and future time charters by allocating the responsibility and costs for ensuring compliance with the EEXI requirements.

The clause stipulates that it is Owners' responsibility to ensure that any 'EEXI Modifications' (defined therein as any physical or technical modifications required to bring the subject vessel in compliance with the EEXI regulations) are completed prior to the vessel's next

annual, intermediate or renewal survey, whichever comes first, on or after 1 January 2023.

If the EEXI Modification relates to an Engine Power Limitation (EPL) or Shaft Power Limitation (SHAPOLI), Owners must determine and inform Charterers about the specification of the modification, the estimated new maximum speed and the corresponding consumption figures of the vessel. Owners are responsible for the time and costs of these modifications, including procurement, purchase, payment, installation and any required trials, but are allowed to take the vessel out of service to effect such modifications. After the modification is completed, the vessel's new maximum speed and corresponding consumption figures as well as any other consequential changes shall be updated in the vessel's description.

Some Owners may choose alternative energy efficiency solutions for their vessels than EPL or SHAPOLI. In such cases, the clause provides that any such other modifications are subject to agreement by Charterers which shall not be unreasonably withheld or delayed.

WHAT TO TAKE INTO ACCOUNT WHEN DRAFTING NEW TIME CHARTERS

The EEXI is not expected to cause any difficult challenges for Owners once the ship has received the

certificate of compliance. The CII, however, will have a serious impact on commercial contracts because it affects fundamental rights of Owners and Charterers in traditional charters. Key areas of impact on future charters which will need to be considered are:

- **Utmost despatch:** Most charters require the ship to proceed using “utmost despatch” or similar. Because Owners may be required to slow steam or sail longer routes in order to meet the CII targets, Owners should have the right to proceed with the most fuel-efficient route. Charterers should also ensure that, by doing so, Owners are not in breach of their utmost despatch obligation nor their obligation to meet Charterers’ orders.
- **Wrongful deviation and off-hire:** Sailing longer routes may constitute a wrongful deviation and accordingly put the ship off-hire. Owners should negotiate appropriate language to allow for sailing longer routes where doing so is necessary in order to comply with the CII.

- **Speed adjustments:** Most charters allow Charterers to slow steam. If Owners intend to reduce the ship’s speed in order to meet the CII, Owners should ensure that new charters also give them the right to do so.
- **Speed and performance warranties:** Owners usually warrant a certain fuel consumption at certain speeds. Owners should ensure that such warranties cover the potential need to deviate from this in order to meet the CII requirements.

BIMCO are also drafting a CII clause, which is scheduled for publication in May 2022. BIMCO have described this aspect as “more challenging” than the EEXI Transition Clause, and that the CII Clause aims to address the annually narrowing emissions “corridor” in a way that balances the operational restrictions imposed on Owners by the low carbon regime against allowing Charterers to optimise the ship’s commercial activity during the charter period. We recognise that this is a challenging exercise, and it will be very interesting to see the balance struck by the drafting committee. •

The new regulations will have a profound impact across all sectors of shipping, and Owners in particular will need to act early in order to understand what measures are required to comply.

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THE EU ETS AND SHIPPING

– updates and unanswered questions

Since the European Commission on 14 July 2021 proposed to extend the scope of its Emissions Trading System (EU ETS) to include emissions from shipping, several stakeholders have evaluated, commented on and assessed the proposal. This article examines some of the most debated and uncertain aspects.

The EU ETS is a “cap and trade” system. Each year, emitters within the sectors included in the scheme have to surrender allowances which fully cover their greenhouse gas emissions. If emissions exceed that permitted by its allowances, the emitter must purchase more allowances. Conversely, if a company has excess allowances at the end of the relevant trading period, it may auction off its leftover credits. The total amount of allowances issued is reduced yearly. Emitters in the included sectors therefore have a financial incentive – as well as a duty – to reduce their emissions.

The European Commission has suggested to revise the EU ETS to include *inter alia* emissions from the shipping sector. In essence, the proposal entails that shipping

companies have to surrender allowances for all emissions that occur on voyages between ports within the EU and whilst ships are at berth at EU ports. Moreover, the Commission’s proposal also requires shipping companies to surrender allowances for 50% of all emissions stemming from international voyages to or from ports within the EU. The EU ETS will apply regardless of whether the ships fly an EU flag or whether the shipowner is incorporated in the EU.

In this article, we turn our attention to the most prominent recent developments with regards to the expansions, namely the Special Rapporteur’s Draft Report (the “**Report**”) and the suggestions of The European Parliament’s environmental committee. We will also assess some key uncertainties concerning how the directive will ultimately affect relevant stakeholders within shipping.

THE SPECIAL RAPPORTEUR’S DRAFT REPORT

On 24 January 2022, Special Rapporteur Peter Liese presented his Report. Regularly appointed during substantial parliamentary considerations, a Special Rapporteur is a MEP which is awarded chief responsibility to review and update a legislative proposal from the European Commission. The Report contains several amendments compared to the proposal put forward by the European Commission 6 months prior.

In general, the Report entails that the EU ETS will be greener, sooner.



In general, the Report entails that the EU ETS will be greener, sooner. For instance, the full application of the directive is moved forward from 2026 to 2025, with shipowners having to surrender allocations for a larger percent of their emissions from 2023 to 2025. Moreover, a duty is imposed on the European Commission to assess the impacts of greenhouse gases other than CO₂ and CH₄. Finally, the Report also recommends implementing an “Ocean Fund”, which shall go towards i.e. improvement of energy efficiency in ships and ports and investments in zero-emission propulsion technologies.

MAIN ISSUES

The Report underscores that the EU ETS will most likely impose more onerous requirements after the EU Parliament has concluded its review. Still, many questions remain unresolved. Some of them will be reviewed in the following.

The Responsible Entity

One issue which has been heavily debated is the division of responsibilities and liabilities under the EU ETS. Both the EU Commission and the Special Rapporteur’s Report assign accountability to the “Shipping Company”, as defined by the ISM Code. The “Shipping Company” is the entity that has assumed the responsibility for the

operation of the ship. Although this definition is found in other international regulations and therefore should be established, concerns have been raised regarding its applicability to the EU ETS, inter alia because the responsible company may change over the reporting period.

The Special Rapporteur has proposed a new article *obliging* companies to enter into contractual relationships: If an entity other than the Shipping Company has assumed “ultimate responsibility” for the purchase of fuel or the operation of the ship, the Member States shall ensure that that entity is contractually responsible to surrender allowances. The Report defines the entity ultimately responsible for the “operation of the ship” as the operator determining the cargo carried by, or the route and speed of, the ship.

The somewhat vague definition of which entity has the ultimate responsibility for the purchase of fuel or the operation of the ship could create uncertainty with regards to what entity is ultimately responsible to cover the costs under the Directive. For instance, whilst the route of the vessel may be decided by the charterer or the commercial manager, the purchase of fuel may be left to the technical manager. It is also uncommon for the EU to infringe on the principle of freedom of contract to this extent. We therefore believe that the entity responsible under the EU ETS will be subject to further debate. Some shipowners may not want the responsible company

The possibilities for contractual regulations might be severely restricted.

under the ISM Code to be responsible for the duties under the EU ETS. If the Special Rapporteur's proposal is not approved, shipowners may contractually regulate an alternative and clearer allocation of responsibilities *inter partes*. For instance, BIMCO has drafted an "ETS Clause", which will apply to the EU ETS and potential similar legislations from other countries. The basis of BIMCO's clause is that the party providing and paying for the fuel under the time charter is the party that is responsible for providing and paying for emissions trading allowances: "The owners must monitor the ship's emissions and provide the relevant emissions data and the basis of calculations to the charterers. Using this information, the charterers transfer the appropriate allowances to the owners monthly. The clause addresses the adjustment of allowances due to offhire events and what happens if the charterers fail to transfer allowances when due."

The Scope of the EU ETS

The international aspects of the directive may also cause uncertainty. Both the EU Commission and the Special Rapporteur have underlined the importance of international action through the International Maritime Organization (IMO). However, whilst the Commission only stated that the EU should consider amendments to the EU ETS if a global market-based measure is approved by the IMO, the Special Rapporteur has proposed further commitments. Firstly, the Report contains an obligation for the EU Commission to engage with the IMO, as well as bilaterally with third countries, to establish agreements to cover all the emissions. Secondly, if a global market-based measure leading to a reduction of emissions in line with the Paris Agreement is not reached by 2028, the EU Commission shall put forward a legislative proposal which covers 100 % of emissions from ships on international sailings, departing from or arriving at an EU port. This would be highly contentious – both legally and politically.

Public law issues might be accentuated as other jurisdictions plan to introduce similar schemes. For instance, the United Kingdom has currently extended a public consultation process to receive feedback regarding a proposed expansion of their emissions trading system to domestic maritime emissions. The more countries outside of the EU that introduce similar schemes, the more difficult it would be for the EU to legitimize an expansion of the EU ETS to include extraterritorial emissions from non-EU flagged vessels.

The scope of the Directive is also of importance for its effectiveness. According to a recently published report from CE Delft (on behalf of the Port of Rotterdam), the regulation is open to circumvention through adding a port call just outside of the EU or feederling from nearby ports. Unless a global measure is agreed, we expect that there will be several attempts to side-step the full effect of the EU ETS, which will result in corresponding amendments from the EU.

FURTHER SPEEDING UP

The European Parliament's environmental committee (ENVI) voted in a meeting mid-May to speed up the inclusion of shipping to the union's Emissions Trading System (ETS) even further. The ENVI's suggestions include *inter alia* deleting the phase-in period (100% of emissions from 2024), extending the geographical scope of the scheme (50% of extra-EU routes from 2024-2026 and 100% from 2027 onwards), allowing shipowners to pass on the carbon cost to the charterer, expanding the type of emission to not only cover CO₂, but also include methane (CH₄) and nitrous oxide (N₂O), and making the ETS scheme applicable to ships of 400 gross tonnage and above (compared to 500 GT in the original proposal).

The report is scheduled for a vote at the plenary session on 6-9 June after which the EU Parliament will be ready to start negotiations with member states. •

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The EU Taxonomy in the maritime transport industry

In the maritime sector, several measures are needed in order to reduce emissions to the extent necessary, and the EU Commission approach this challenge by presenting a basket of measures, one of them being the EU Taxonomy. By setting harmonised criteria for determining whether an economic activity qualifies as environmentally sustainable, it is intended to incentivise the greening of the sector.



According to the Taxonomy, an economic activity must meet three overarching requirements to qualify as environmentally sustainable;

- substantially contribute to at least one of the environmental objectives
- do no significant harm to the other objectives; and
- meet the requirement to comply with certain minimum social safeguards

It is not a requirement for businesses to be taxonomy-aligned, and investors will continue to be free to choose the companies they invest in. However, investors and lenders are increasingly relying on the EU Taxonomy when assessing whether an investment is in fact environmentally sustainable. The main objective of the EU Taxonomy is to redirect capital towards sustainable activities, and companies not meeting the Taxonomy requirements may face increasing difficulty in accessing new capital and financing.

Being classified as taxonomy-aligned is therefore expected to be increasingly important when attracting new capital or securing financing. The maritime industry is capital intensive, and large investments must be made if the industry shall transition towards climate neutrality. Access to competitive green financing and capital is key to develop the new technology and solutions necessary to transition the industry.

THE REQUIREMENTS TO THE SHIPPING INDUSTRY

In April 2021, the European Commission established technical screening criteria applicable to, among other sectors, the maritime transport industry. The EU Commission has provided a list of environmentally sustainable activities relevant for the shipping industry in its technical screening criteria. The shipping activities which are considered to substantially contribute to the

environmental objectives, and thus meeting the first overarching criteria, are divided into the following 6 categories:

- Inland passenger water transport
- Inland freight water transport
- Retrofitting of inland water passenger and freight transport
- Sea and coastal freight water transport, vessels for port operations and auxiliary activities
- Sea and coastal passenger water transport
- Retrofitting of sea and coastal freight and passenger water transport

Vessels dedicated to the transport of fossil fuels may never be considered to substantially contribute to the aforementioned environmental objectives.

Within these categories, a range of activities are considered to meet the “substantial contribution” criteria, including the purchase, financing, chartering, leasing and operation of vessels. The relevant activities vary somewhat depending on which of the above mentioned categories are applicable.

The EU Taxonomy distinguishes between economic activities where CO₂ emissions are very low, “low-carbon activities”, and “transition activities”, in which the emissions are significantly lower than that of the industry average. The latter is the relevant alternative for the majority of the shipping activities, as there are few low carbon solutions applicable for the maritime industry.

For shipping in general, zero direct tailpipe CO₂ emissions is a requirement in the technical criteria for substantial contribution to climate mitigation. A buffer period

Being classified as taxonomy-aligned is expected to be increasingly important when attracting new capital or securing financing.

will apply until 2025 to allow a certain amount of direct emissions, depending on what the vessel is used for. Generally speaking, vessels will meet the criteria if they derive a minimum of 25 % of its energy from zero direct emission fuels. However, there are very few such fuels available.

EXTENDED ENVIRONMENTAL TAXONOMY

Another challenge is that the EU Taxonomy does not define how activities that do not meet the criteria, should be treated. A company may be making large investments and important progress towards being climate neutral, without being classified as taxonomy-aligned. However, access to finance through non-green activities may be important for a successful transition.

The current system in the “green” taxonomy does not distinguish between activities that harm the environment and activities that just narrowly fail the sustainability test. Moreover, low-impact activities may collectively contribute to environmental goals.

To cater for this, on March 29, 2022, the European “Platform on Sustainable Finance” expert group published its report on a future “Extended Environmental Taxonomy”. The report considers the EU Taxonomy’s overall binary (“green”/“non-green”) approach to be insufficiently differentiated. The report therefore considers whether and how to extend the EU Taxonomy to also cover activities that have a mixed impact on environmental sustainability (“amber”), and activities that – to the opposite extreme – have a significantly detrimental impact on the environment (“red”).

The Platform recommends introducing new categories into the EU Taxonomy and graduating its approach, so as to cover potentially the entire economy. To facilitate the understanding of this new structure, the Report recommends using a traffic light colour scheme:

Substantial environmental harm (must decommission)	Substantial environmental harm (may transition)
Intermediate performance	
Substantial contribution to environmental sustainability	
Low environmental impact activities	

The Report specifically mentions shipping as a sector identified for transition finance. Reaching the “green” taxonomy level is considered especially hard for the shipping industry, as the decarbonisation challenge is extremely complex and hinging on an collaborative approach from governments, investors and banks. An extended taxonomy could therefore prove very beneficial for the shipping industry.

The need to finance transition activities in the shipping sector has already been picked up by some investors and financial institutions. For example, as elaborated upon in the Transition Linked Finance article in this newsletter, Transition-Linked Financing Guidelines were developed by KLP and other Nordic financial institutions earlier this year. The Guidelines set out specific targets and indicators for borrowers within the shipping industry, encouraging further alignment with the EU Taxonomy even if they are not currently taxonomy-aligned. With an Extended Taxonomy, investment in transition activities at the “amber” and “red” level would be incentivised and recognised also by the EU Taxonomy system. •

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Key aspects of the new FuelEU Maritime proposal

On 14 July 2021, the European Commission presented a package of proposals aimed at ensuring that the European Union achieves its goals of cutting greenhouse gas emissions by at least 55% by 2030. The proposals include, among other things, the new FuelEU Maritime initiative, specifically aimed at the shipping industry.

The FuelEU Maritime proposal is highly technical in nature. However, at its core, the proposal aims to implement two specific measures, namely:

- an obligation for certain types of vessels to use an onshore power supply or zero-emission technology in ports; and
- the introduction of increasingly stringent limitations on the carbon intensity of fuels/energy used on board vessels.

The obligation to use an onshore power supply or zero-emission technology in ports is so far only proposed to apply to container ships and passenger vessels, and is not set to kick in until 1 January 2030.

Due to this measure's limited application, this article focuses on the second measure, namely the requirement to reduce the greenhouse gas intensity of fuel/energy used on board vessels.

The reason for limiting its

application only to container and passenger vessels is that these are the vessels which, according to data collected by the European Union, produce the highest amount of emissions at berth. Although this part of the regulation currently has a limited scope, there is a relatively high likelihood that the scope may be expanded to include other vessel types in time.

LIMITING GREENHOUSE GAS INTENSITY OF ENERGY USED ON BOARD VESSELS

As drafted, the proposed limitation on greenhouse gas intensity will apply only to vessels with a gross tonnage of over 5,000, regardless of the vessel's flag. Various types of vessel will however be exempted, such as fishing vessels, naval vessels and government vessels used for non-commercial purposes.

For those vessels to whom the proposal will apply, the required reductions will be applied over time based on the following timeline:

- a reduction of -2% from 1 January 2025;
- a reduction of -6% from 1 January 2030;
- a reduction of -13% from 1 January 2035;
- a reduction of -26% from 1 January 2040;
- a reduction of -59% from 1 January 2045; and
- a reduction of -75% from 1 January 2050.

How these reductions are to be achieved is not specified however. As a result, there has been some criticism that many shipowners will, at least initially, simply look to switch from more carbon heavy bunker fuels to lower emission fuels such as liquefied natural gas (from fossil fuel sources) and biofuels rather than seeking to switch to the use of zero-emission fuels such as electricity, hydrogen and ammonia. Whilst the European Commission has responded to such criticism by including specific provisions

aimed at reducing the use of bio-fuels, biogas, renewable fuels of non-biological origin and recycled carbon fuels in its proposal, there will no doubt be continued criticism that the proposals do not go far enough, at least in the early phase of its application.

In terms of its scope, the regulation is intended to apply to all energy used on voyages between EEA member states' ports of call. To disincentivise shipowners from seeking to avoid their responsibilities by evasive port calls, it will also apply for voyages departing from or arriving to a member state port of call but where the last or the next port of call is in a third country outside the EEA, albeit to only 50% of the energy consumed.

In the event that a vessel has a compliance surplus for a particular reporting period, it is proposed that shipowners may bank that surplus to the same vessel's compliance balance for a subsequent period and if a vessel has a compliance deficit for a reporting period, shipowners may, within certain limits, borrow from a future compliance surplus. Shipowners will also be allowed to pool the performances of different vessels within a fleet and use the possible overperformance of one vessel to compensate for the underperformance of another vessel.

The person or organisation responsible for compliance with the regulation is intended to be the shipowner or any other organisation or person, such as the manager or the bareboat charterer, who has assumed the responsibility for the operation of the vessel from the shipowner. This definition is in line with similar definitions used by the IMO, for example, in its 1994 international

safety management code for the safe operation of ships and pollution prevention (the ISM Code), as well as the definition proposed for the EU ETS ([which is covered in the article on page 8 in this newsletter](#)). Shipowners that wish to hold other entities responsible for penalties and other losses which may occur will therefore need to ensure that this is clearly specified in their contracts.

The relevant responsible entity will then be responsible for monitoring and reporting relevant data for each of its vessels. Monitoring and reporting must be complete and cover the energy used on board vessels whilst they are at sea as well as at berth and the data provided will be required to be verified by accredited, independent and competent verifiers. Based on the data, the verifiers will then calculate and establish the annual average greenhouse gas intensity of energy used and the vessel's balance with respect to the applicable limit. Provided that there is no deficit, the verifier will issue a FuelEU certificate of compliance. Vessels will be obliged to carry this certificate.

For any vessel that does not meet the annual limits, a penalty system will be established. The penalties will be calculated on the basis of specific rules set out in an annex to the regulation, but generally based on the amount and cost of renewable and low-carbon fuel that the vessels should have used in order to meet the relevant requirements and the FuelEU certificate of compliance will not be issued until all penalties have been paid. Within the European Union, penalty payments received will be allocated to support projects aimed at the rapid deployment of renewable and low-carbon fuels in the shipping sector.

COMMENT

After the FuelEU Maritime proposal was presented, many stakeholders have highlighted that a global approach is necessary in order to tackle greenhouse gas emissions from the shipping sector, and that the FuelEU Maritime proposal should be harmonised with the work being done at the IMO. However, after IMO's Marine Environment Protection Committee (MEPC) 77, which was held in November 2021, it seems unlikely that there will be any significant developments at the IMO before 2023. In order to achieve its goals of cutting greenhouse gas emissions by at least 55% by 2030, the EU might therefore in any event have to act before any international rules are adopted by the IMO. •

Shipowners will be allowed to pool the performances of different vessels within a fleet and use the possible overperformance of one vessel to compensate for the underperformance of another vessel.

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TRANSITION-LINKED FINANCING

THE TRANSITION TO A **GREENER** SHIPPING INDUSTRY

A group of Nordic market participants have through the Green Shipping Programme produced a new set of Guidelines for Transition-Linked Financing (TLF) supporting the transition to net zero emissions in the shipping industry by 2050.



A general challenge for the shipping industry is that low- and zero-emission technology and infrastructure may not yet be available or commercially viable for large scale operations. Within the shipping industry in general there is thus a need for transition linked finance arrangements which can complement Green Loans or Green Bonds (see text box) that (for now) are more suitable for bespoke projects in this sector. Sustainability linked finance guidelines and principles have been introduced in the wider market in respect of green activities and performance improvements for owners, but there has until now not been any specific methodology or recommendations for transitional activities for the shipping sector with clear and sufficiently ambitious environmental objectives. The lack of standardised principles for the industry increases the risk of greenwashing and makes it difficult for investors and lenders to compare projects and owners.

The new guidelines for TLF particularises from an industry specific perspective how to align performance towards net-zero by 2050 in line with the Paris Agreement as well as towards compliance with the “do no significant harm” criteria under the environmental objective for climate change mitigation in the EU Taxonomy.

The guidelines for TLF adopt the same structure and methodology as the SLLPs/SLLBs guidelines (see text box), but are tailored for the shipping

sector and focus on (1) how to select transitional Key Performance Indicators (KPIs), as well as defining specific reporting requirements addressing a need for increased transparency and accountability. The key elements of these principles are as follows:

(1) Key Performance Indicators: Owners should select KPIs that are material to the company’s transition strategy, measurable, externally verifiable and benchmarkable. More specifically, owners should report performance on selected KPIs for decarbonisation, with the emission intensity indicator “Annual Efficiency Ratio” as a starting point. In addition, owners should take steps towards alignment with the “do no significant harm” criteria of the EU Taxonomy, which includes reporting on circular economy transitions (i.e. waste handling and ship recycling) and protection and restoration of biodiversity and ecosystems (i.e. underwater noise and vibration and biofouling).

The guidelines recognise the need for a transitional period for the shipping industry to reach net zero.

(2) Sustainability Performance Targets: Calibration of targets should represent measurable, material improvements in KPIs and should go demonstrably beyond “business as usual”. The guidelines provide further guidance on KPI selection, trajectory construction and guidelines for calculating and reporting for different companies – providing a goal setting framework both for owners with emissions at or below the relevant

trajectory (“transition leaders”), and owners with emissions above the relevant trajectory (“transition accelerators”). For decarbonisation, SPTs should match the target for zero green house gas emissions in 2050 and the owners must meet the transitional target set within the tenure of the loan or bond.

Targets should be based on best available technologies and operating practices, not expectations of what could become available in the future. It should be also noted that using carbon credits will not count towards the company’s achievement of the SPTs.

(3) Loan characteristics: This follows the SLBPs/SSLPs, so that an economic outcome (e.g. a lower margin on the interest rate) is linked to whether the selected SPT(s) are met.

(4) Reporting: The SLLPs/SLBPs also apply to reporting requirements, but the guidance for TRF places greater emphasis on owners’ disclosure of and accountability for its transitional activities and measures. Owners will have to report their compliance to the financial institution on an annual basis, which shall include carbon intensity, compliance with targets, assessment of performance and the “do not significantly harm” criteria. As a means of creating increased levels of trust and accountability, the guide encourages owners to publicly disclose their performance, their overall environmental strategy and ambition levels.

(5) Verification: This criteria also follows the SLLPs/SLBPs, so that the owner must obtain independent

and external verification of its performance level against each SPT and each KPI.

In addition to the above factors, the TLF guidelines note that as part of an owner’s plan to transition into a sustainable business model, owners are as a matter of best practice encouraged to follow the recommendations set out in ICMA’s Climate Transition Finance Handbook.

In our view the TLF guidelines provide a very useful financial framework that will be beneficial for both lenders and owners in the shipping industry for two main reasons:

- The guidelines recognise the need for a transitional period for the shipping industry to reach net zero, whilst encouraging transition within the timescales set out in the Paris Agreement and linked to alignment with the EU Taxonomy.
- By providing a sector specific framework it also reduces the risk of green washing (and allegations of greenwashing), and makes it possible to make meaningful comparisons between owners and loans. In the short term, the guidelines can provide a framework giving owners access to better financing terms. In the longer term however - with increasing expectations to sustainability and transparency - demonstrating a real commitment and results towards a more sustainable business is likely to become critical in order for owners to continue to access financing.

We are encouraged by the efforts made to develop these guidelines, and hope to see them actively used in the negotiation of loan agreements going forward. •

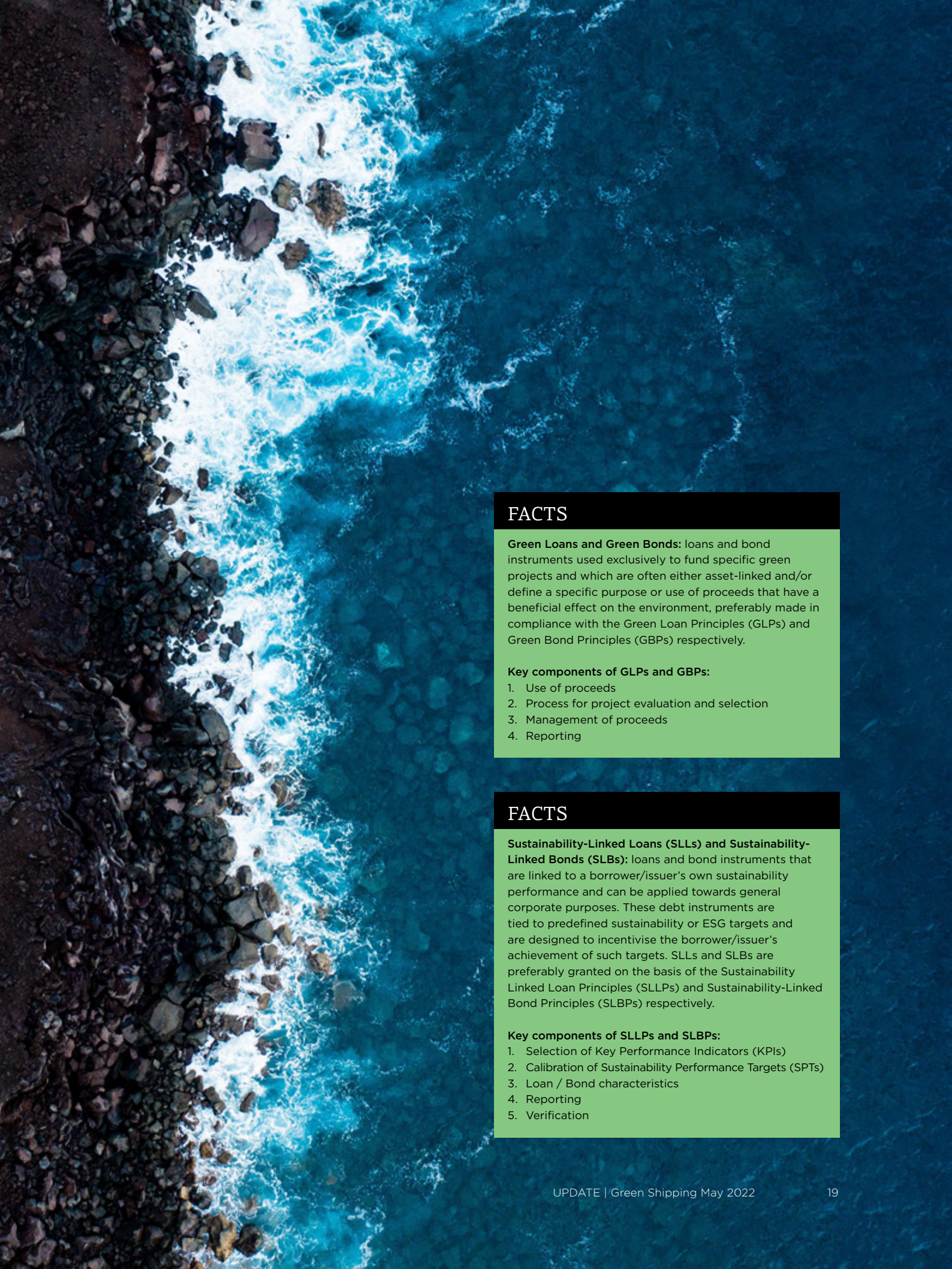
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Green Loans and Green Bonds: loans and bond instruments used exclusively to fund specific green projects and which are often either asset-linked and/or define a specific purpose or use of proceeds that have a beneficial effect on the environment, preferably made in compliance with the Green Loan Principles (GLPs) and Green Bond Principles (GBPs) respectively.

Key components of GLPs and GBPs:

1. Use of proceeds
2. Process for project evaluation and selection
3. Management of proceeds
4. Reporting

FACTS

Sustainability-Linked Loans (SLLs) and Sustainability-Linked Bonds (SLBs): loans and bond instruments that are linked to a borrower/issuer's own sustainability performance and can be applied towards general corporate purposes. These debt instruments are tied to predefined sustainability or ESG targets and are designed to incentivise the borrower/issuer's achievement of such targets. SLLs and SLBs are preferably granted on the basis of the Sustainability Linked Loan Principles (SLLPs) and Sustainability-Linked Bond Principles (SLBPs) respectively.

Key components of SLLPs and SLBPs:

1. Selection of Key Performance Indicators (KPIs)
2. Calibration of Sustainability Performance Targets (SPTs)
3. Loan / Bond characteristics
4. Reporting
5. Verification

Legal challenges with cross border transportation of CO₂

According to the report “Climate Change 2022: Mitigation of Climate Change”, published 4 April 2022, carbon capture and storage (CCS) is essential in order to reduce carbon dioxide (CO₂) emissions and reach the climate goals. When establishing an international value chain for CCS, the industry will have to work within the international rules and framework. This article focuses on the restrictions on export of CO₂ in the “London Dumping Regime”, especially the London Protocol.







In an attempt to reduce CO₂ emissions from plants and heavy industry, the Norwegian government and industry have for several years been working on the “Longship-project”. This project is a full-scale CCS project. The initial focus is to capture CO₂ at facilities on the eastern coast of Norway. There, the CO₂ will be made into liquid form and collected by vessels, before being transported to an intermediate storage facility on the western coast of Norway. The CO₂ will at arrival be pumped through pipes to the Norwegian continental shelf where it will be permanently stored.

Carrying liquid CO₂ by vessels is intended to be scalable, in the sense that it also may facilitate the extraction of liquid CO₂ from several additional sources. The intermediate storage facility on the western coast of Norway, and the storage on the Norwegian continental shelf, also have additional capacity, and it is intended that the project may collect and store liquid CO₂ from other industry actors, including from those outside Norway.

Northern Lights, which is responsible for developing and operating the transport and storage facilities in the Longship-project, and

Cory, a UK waste management and recycling company, announced on 13 May 2022 that they have entered into a Memorandum of Understanding (MoU) to explore the opportunity to ship carbon from Cory’s energy from waste operations in London to Northern Lights’ carbon storage facilities in Norway.

A challenge for international CCS-projects is the international legal framework which applies to export and cross border transport of CO₂. Many international rules and treaties are relevant in this respect. This includes the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter 1972 (the “London Convention”) and its 1996 protocol (the “London Protocol”), which often collectively are referred to as the “London Dumping Regime”. The objective of the London Dumping Regime is to prevent marine pollution by dumping of wastes. This article focuses on giving a brief overview of the current status on

Countries involved in cross border transport of CO₂ will have to enter into bilateral agreements or understandings.

export and cross border transport of CO₂ under the London Protocol.

CROSS BORDER TRANSPORT OF CO₂ UNDER THE LONDON PROTOCOL

According to Article 6 of the London Protocol, “*Contracting Parties shall not allow the export of wastes or other matters to other countries for dumping or incineration at sea*”. Hence, the London Protocol initially prohibits export of CO₂ for storage as this is regarded as “*incineration at sea*”. Previously, many have highlighted that this may cause significant difficulties for the creation of a market for international transport and storage for CO₂.

The signatories to the London Protocol have also recognised this, and in 2009 an amendment to the London Protocol was proposed. The proposed amendment makes an exception to the prohibition of export of CO₂, stating that “*the export of carbon dioxide streams for disposal*” may occur as long as “*an agreement or arrangement*” has been entered into by the countries concerned. Accordingly, the proposal stipulates that the countries involved in cross border transport of CO₂ will have to enter into bilateral agreements or understandings.

Agreements or arrangements must be notified to the International Maritime Organization (“IMO”), and shall include “*confirmation and allocation of permitting responsibilities*” between the involved countries consistent with the London Protocol and other applicable international law. Moreover, if the CO₂ is exported to a state which is not a party to the London Protocol, the agreement or arrangement shall include “*provisions at a minimum equivalent to*” the ones of the London Protocol.

The amendment to the London Protocol was signed by Norway in 2010. However, Article 21 of the London Protocol requires a two-thirds majority vote which has not as of yet been obtained. As of today’s date, the amendment has not been ratified, and it is therefore formally not in force. The lack of ratification has been sought resolved by the adoption of a proposal from Norway and the Netherlands for the provisional application of the 2009 changes (Resolution LP.5(14) on the Provisional Application of the 2009 Amendment to Article 6 of London Protocol).

The above-mentioned resolution was adopted 11 October 2019, and allows for “*the provisional application of the 2009 amendment pending its entry into force by those Contracting Parties which have deposited a declaration on provisional application of the 2009 amendment*”. Norway gave its declaration to IMO in 2020, the result being that Norway may enter into an agreement or arrangement on export of CO₂.

As of today, no agreements or arrangements have been produced. However, on 5 April 2022, the Norwegian government issued a press release stating that the Norwegian and Swedish prime ministers have agreed to put in place an agreement between the two countries as soon as possible. Due to the recent entering into of the MoU between Northern Lights and Cory, it is also likely that Norway and the United Kingdom soon will start to work on a bilateral agreement or arrangement.

CHALLENGES FOR INTERNATIONAL CCS-PROJECTS GOING FORWARD

Although there are mechanisms in place which may ensure that

the original prohibition in Article 6 of the London Protocol is not a “show-stopper” in itself for cross border transport of CO₂, the lack of an unified international solution remains a key challenge. In this relation, it is also worth noting that the London Protocol only has been ratified by 53 states, compared to the London Convention with its 87 states. Consequently, once the 2009 amendment to the London Protocol has been ratified, its application will be limited, unless it becomes regarded as generally accepted rules and regulations according to the 1982 United Nations Convention on the Law of the Sea (UNCLOS).

In addition to the lack of a unified international solution, the requirement of bilateral agreements or arrangements may be viewed as a challenge for international CCS-projects in itself as it is not sufficient for countries to simply ratify the 2009 amendment and/or deposit the declaration for its provisional application. We await with interest further developments from the contracting parties as CCS-projects continue to mature. •

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The green transition and support in the operational phase

The maritime sector has for many years been actively developing new technology which aims to ensure that the green transition and the climate goals can be achieved. The sector is now close to being ready to take the next steps. However, unless some form of public support is introduced for the operational phase, the transition will likely take more time than some may wish for.

In the past few years, both the International Maritime Organization (IMO) and the European Union (EU) have, as part of their strategy to tackle climate change and reduce greenhouse gasses, adopted and proposed several new rules and regulations designed to reduce emissions from the maritime sector. For instance, IMO adopted new energy efficiency requirements in June 2021, with the introduction of the Energy Efficiency Existing Ship Index (EEXI) and Carbon Intensity Indicator (CII). Around the same time, the European Commission, as part of their “Fit for 55”-package, presented two proposals: the FuelEU Maritime and the extension of the EU Emissions Trading System (ETS) to the shipping sector.

The new IMO rules will require shipowners to assess energy consumption and CO₂ emissions for existing ships against specific requirements for energy efficiency. The CII designates the vessels covered by the regulation an annual rating between A and E depending on the efficiency of the ship. The requirements for each rating become increasingly stringent over time. If a ship achieves a D rating for three consecutive years or an E rating in a single year, a corrective action plan needs to be developed as part of the ship’s Ship Energy Efficiency

The support schemes generally only provide economic support and grants for capital expenditures (CAPEX), not for operational expenditures (OPEX).

Management Plan (SEEMP). The EU proposals form part of the EU’s “basket of measures” designed to address emissions from the shipping sector and specific market failures. The purpose of the FuelEU Maritime initiative is to increase demand for renewable and low-carbon fuels in the shipping sector. Implementation of the ETS aims to ensure cost-effective emission reductions, and that the price of transport reflects the impact it has on the environment, health and energy security.

Most of the projects regarding development of new technology have received some form of public economic support.

THE INDUSTRY HAS ALREADY BEEN ANSWERING THE CALL – NEW TECHNOLOGY IS EMERGING

With the IMO and the EU's emphasis on climate change and reduction of greenhouse gasses, we have seen an increased focus from the industry on developing new technology, both in Norway and abroad. The purpose of the new technology is primarily to ensure that the green transition and the climate goals can be achieved. Currently, there are numerous projects ongoing on all levels of the maritime value chain. For example, improved batteries and fuel cells are being developed, aimed at increasing the use of low and zero emission fuels and energy carriers such as hydrogen and ammonia. Further, new ships which will make use of new technologies are being designed and built, and some ships are retrofitted with new technology.

Most of the projects regarding development of new technology have received some form of public economic support. In Norway and within the EU there are several different support schemes, including in particular support schemes from Enova, Innovation Norway and the Norwegian Research Council in Norway. The criteria for receiving support, as well as the amount of economic support (grants) received, depend on the specific project and the conditions which are specified by the public entities. However, and although there are some exceptions such as the EU's Important Project on Common European Interest (IPCEI), the support schemes generally only provide economic support and grants for capital expenditures (CAPEX), not for operational expenditures (OPEX).

THE TECHNOLOGY IS ALREADY AVAILABLE, AND THE MARITIME INDUSTRY IS READY ...

The lack of support schemes for operational expenditures means that the current support schemes, at least in Norway, are not suitable for addressing market failures and risks in the operational phase. This is by many now viewed as the primary reason for why the maritime sector's green

transition is not going as fast as some may want. The use of hydrogen as a zero emission energy carrier for ships is perhaps the most illustrative example in this respect. The use of hydrogen will not only lead to increased operating costs for shipowners compared to conventional fuel (due to the price difference); there is currently also not a fully functional value chain for the use of hydrogen within the maritime sector, which means that it in any event will be difficult to implement on a larger scale. Therefore, while the technology to a large extent is available, few – if any – shipowners wish or are able to be the first mover and take all the increased costs and risks associated with it.

The market failure, both in terms of investment in corresponding production capacities, and availability and use of hydrogen, will likely be difficult to overcome without some form of public economic support. Although due consideration is necessary in light of state aid and competition law rules, many different models could be considered implemented, including Contracts for Difference (CfD), establishing specific funds aimed at addressing the market failures, or a combination of this (use of funds to finance the CfDs). Such support schemes have already been used outside Norway with significant success. We now also see that other models based on the same principles as CfD, such as Germany's recent EUR 900 million funding of "H2Global", are being implemented in order to kick-start the transition.

Support schemes in the development phase have proven to be an effective catalyst for development of new technology. In order to speed up the green transition within the maritime sector, the industry and the public authorities now need to sit down, discuss and find models for the operational phase. Norway could in this respect look to what has already been done in other European countries, including implemented and well-known concepts such as the CfD, specific funds, and new emerging public funding/support models such as Germany's H2Global-model. •

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The most
important
updates in

GREEN SHIPPING

- May 2022



In this recurring segment, we provide a high level overview of the most important regulatory updates in green shipping, intended as a quick guide to stay updated.

	 Regulation ¹	 Essence of regulation
Technical Requirements	Existing Energy Efficiency Design Index (EEXI)	Existing vessels must, through a one-time certification, comply with a minimum energy efficiency level set by the IMO.
	Ballast Water Management Convention (BWM Convention)	To prevent foreign organisms entering other ecosystems, vessels must implement a ballast water and sediments management plan, hold a ballast water record book, and use an approved ballast water treatment system.
	Energy Efficiency Design Index (EEDI)	New vessels are required to satisfy a minimum energy efficiency level per tonne mile for different vessel type and size segments. The required efficiency level is tightened every five years, next in 2025.
Operational Requirements	FuelEU Maritime	Vessels must use an onshore power supply or zero-emission technology in ports, and adhere to increasingly stringent limitations on the carbon intensity of fuels/energy used on board.
	Carbon Intensity Indicator (CII)	The annual CO ₂ emissions arising from a vessel's operation will get an operational carbon intensity rating from A to E, with vessels rated D for three consecutive years, or E, having to submit a corrective plan.
	IMO 2020	Vessels may only use fuels with a maximum sulphur content of 0.5%, by either using low-sulphur fuel or implementing cleaning exhaust systems approved by the flag state of the vessel.
	Ship Energy Efficiency Management Plan (SEEMP)	The ship operator must establish a ship specific plan to attain improved energy efficiency. In case of vessels of 5000 GT or above, the SEEMP shall also include a description of the methodology used to collect emissions data.
Commercial Incentives	EU Emissions Trading System (EU ETS)	Shipping companies must surrender allowances for their vessels emissions under the EU's "cap and trade" emissions trading system.
	EU Taxonomy	The EU Taxonomy for sustainable activities is a classification system established to which investments are environmentally sustainable, in the context of the European Green Deal.
	Poseidon Principles	A global framework establishing a common baseline to quantitatively assess and disclose to what extent financial institutions' lending shipping portfolios are in line with adopted climate goals.

¹ The table includes a high level summary of some of the most influential and important regulations related to Green Shipping, but is not exhaustive



Scope
(technical)



Scope
(geographical)



Implementa-
tion date



Next steps

	Scope (technical)	Scope (geographical)	Implementa- tion date	Next steps
	Certain vessel types over 400 GT (including bulk carriers, general cargo ships, tankers, ro-ro ships and containerships)	Worldwide	Legislation effective from 1 November 2022, compliance required from 1 January 2023	1 January 2023: Compliance is required
	Applies to all vessels as a starting point, but not necessarily to vessels solely operating within one jurisdiction	Worldwide	8 September 2017	1 June 2022: Amendments concerning inter alia testing of ballast water management systems and the form of the International Ballast Water Management Certificate
	New or majorly converted vessels over 400 GT	Worldwide	1 January 2013	1 January 2025: Phase 3 requiring increased energy efficiency to initiate
	Certain types of commercial vessels over 5000 GT	All voyages between ports, and at berth, in the EU, and 50% of GHG intensity of onboard energy used during voyages which start or end at an EU port.	Proposed implementation date 1 January 2025, with stricter requirements every five years	Second half of 2022: Final text expected 1 January 2025: Proposed implementation
	Certain vessel types over 5000 GT (including bulk carriers, general cargo ships, tankers, ro-ro ships and containerships)	Worldwide	Legislation effective from 1 November 2022, compliance required from 1 January 2023 (more stringent rating thresholds towards 2030)	1 January 2023: Compliance is required
	All vessels	Worldwide, with stricter requirements within emission control areas	1 January 2020	1 April 2022: Amendments on sulphur content definition and samplings
	Vessels over 400 GT	Worldwide	1 January 2013	
	Vessels over 5000 GT	100% of emissions between EU ports and within the EU, 50 % of emissions from international voyages to or from the EU	Proposed implementation date 1 January 2023	Second half of 2022: Final text expected 1 January 2023: Proposed implementation
	Reporting obligations for large companies that fall under the scope of the NFRD (large public-interest companies with more than 500 employees), and financial market participants	Companies based in Europe, or operating as a European legal entity	12 July 2020, the first of the disclosure obligations was applicable from 1 January 2022.	<ul style="list-style-type: none"> • Spring 2022: technical screening criteria for the remaining four environmental objectives and developing the social, neutral and brown taxonomy • Including nuclear energy and natural gas. The European Parliament and Council have four months to formulate objections to the Commission's suggestion, two additional months if deemed necessary.
	Banks and lenders	Worldwide	18 June 2019	December 2021: Poseidon Principles for Marine Insurance introduced

WIKBORG REIN'S RIG AND SHIP RECYCLING SERVICES

The Basel Convention, the European Waste Shipment Regulation and the European Ship Recycling Regulation have introduced complex regimes, the full implications of which need to be considered extremely carefully. Local due diligence is required to understand and manage the often conflicting requirements in states of export, import and transit. Owners and other parties involved in ship or rig recycling projects need legal advisers who are experienced with all aspects of the Basel Convention regime, the practical issues arising in connection with Basel notifications, and the idiosyncrasies of the application process in a range of jurisdictions.

Our team has assisted clients in numerous recycling projects in Europe, the Middle East, West Africa, Asia and the Americas, and has particular experience in:

- General advice regarding shipments of waste;
- Local due diligence;
- Drafting and negotiation of agreements for sale and recycling;
- Drafting and negotiation of supervision agreements;
- Management of applications to regulators in jurisdictions of export, transit and import;
- Liaison with regulators;
- Drafting and negotiation of bank and corporate guarantees to regulators;
- Drafting and negotiation of bi- and tripartite towage contracts;
- Assistance in disputes under agreements for sale and recycling;
- Assistance in connection with investigations/prosecutions of alleged breaches of waste shipment and ship recycling legislation.

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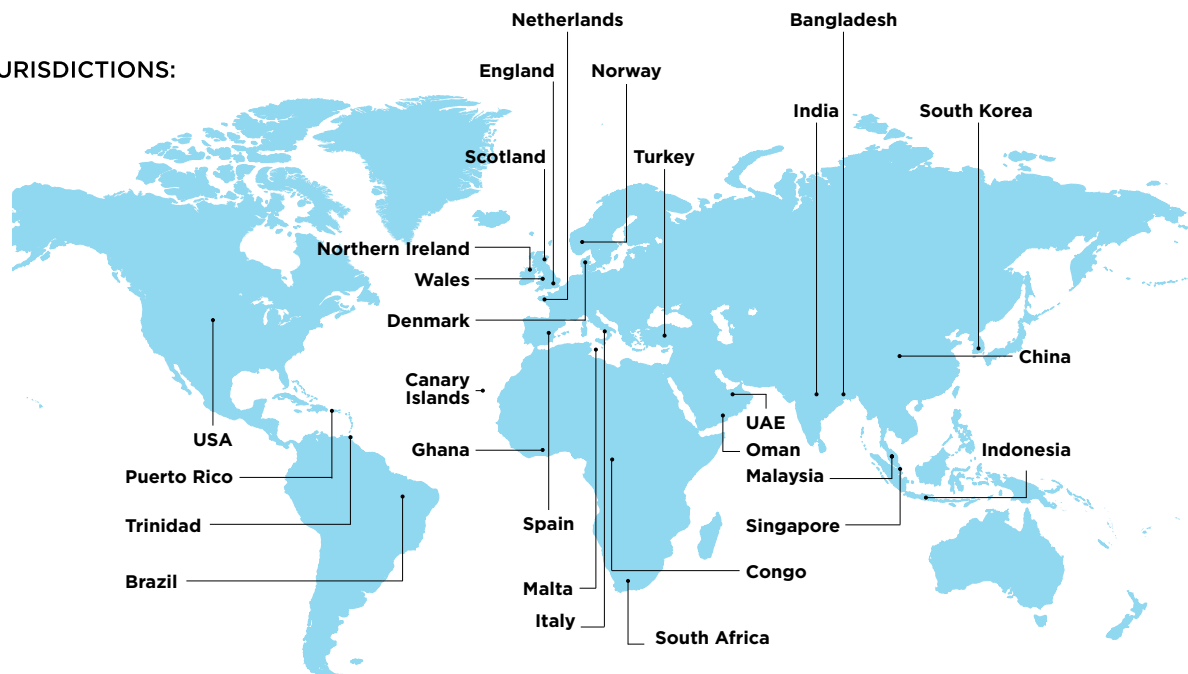


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