EU EMISSIONS TRADING SYSTEM: EVALUATING THE POTENTIAL IMPACT ON SHIPPERS AND FREIGHT FORWARDERS

In light of the fast-approaching extension of the EU Emissions Trading System (EU ETS) to the maritime transport sector, HFW's Matthew Gore takes a look at how carriers are preparing to pass on the associated additional costs, and the likely effects on shippers and freight forwarders (customers).

	West Coast South America to Europe Estimated Emissions Surcharge* (EUR)	
Carrier	**Dry per FFE**	**Reefer per FFE**
Maersk[6]	74	111
Hapag-Lloyd[7]	12	21
CMA-CGM[8]	43	60
MSC[9]	31	47

* These figures are accurate as of 31 October 2023.

6. EU Emissions Trading System (ETS) effective January 1, 2024 | Maersk
7. Your business, the EU Emission Trading System and container shipping - Hapag-Lloyd
8. CMA CGM | Preparing for the EU Emissions Trading System application to shipping (cma-cgm.com)
9. Implementing EU ETS from 1 January 2024 | MSC

The EU ETS is the largest emissions trading system in the world and will (for the first time since its inception in 2005) be extended to cover maritime transport from 1 January 2024. From this date, regulated greenhouse gas (GHG) emissions (i.e. carbon emissions)[1] from vessels of 5,000 gross tons and above will be within the scope of the EU ETS. Complying 'shipping companies' will be liable to financially account for: (i) 100% of a vessel's emissions if travelling between two EU ports of call; (ii) 100% of a vessel's emissions during an EU port of call; and (iii) 50% of a vessel's emissions between an EU port of call and a non-EU port of call, or vice versa.

There are, however, exceptions, and there will also be a phase-in period for the application of the EU ETS to maritime transport. To ensure a smooth transition, shipping companies will only have to surrender EU Allowances (EUA) to reflect (i) 40% of verified GHG emissions reported in 2024; (ii) 70% of verified GHG emissions reported in 2025; and (iii) 100% of verified GHG emissions from 2026 onwards.

For more information, please see the previous HFW update.[2]

The Emissions Surcharge

With the expansion of the EU ETS comes a potentially significant increase in carriers' costs. For example, as of 31 October 2023, the cost of one EUA was approximately EUR79. Taking that figure, and assuming that burning one tonne of fuel emits approximately three tonnes of CO_2),[3] carriers could be looking at an additional EUR240 per tonne of fuel burned.

In light of this, and given an already challenging freight market, carriers are seeking to pass on these costs to their customers through an emissions surcharge. This surcharge seeks to cover the carriers' costs of EUAs relating to the voyage in question. However, the calculation of the surcharge is complex, because:

1. The annual deadline for complying shipping companies to surrender EUAs corresponding to the relevant vessel's verified emissions (or, for 2024 and 2025, the relevant proportion of such emissions) is 30 September of the following year.
2. Consequently, whilst many carriers may purchase EUAs promptly, some carriers may not come to purchase EUAs until months after a voyage has completed (as, for example, EUAs relating to a voyage in February 2024 would not need to be surrendered until 30 September 2025, over 18 months later).
3. In the meantime the price of EUAs may diverge from the price assumed when calculating the emissions surcharge. EUAs are highly volatile and their price is subject to market factors (i.e. supply/demand and geopolitical/environmental factors). Indeed, EUAs saw a substantial downturn after the commencement of the Russian-Ukraine conflict (falling from EUR95 to EUR55 in one week),[4] but only a year later in February 2023 reached an all-time high of EUR100.[5]

Given this complexity, carriers are attempting to estimate the level of their emissions surcharges for different trades, which they will update quarterly following the EUA Price Index. However, because of the complexity, surcharges differ significantly, as can be seen from the table above.

It is likely that carriers may underestimate or overestimate the potential cost of EUAs, and consequently under or over charge their customers accordingly, in

1 The EU ETS covers CO_2 (carbon dioxide) and will cover CH_4 (methane) and N_2O (nitrous oxide) emissions from 2026 onwards.
2 https://www.hfw.com/The-Formal-Inclusion-Of-Maritime-Transport-In-The-EU-ETS-Key-Features-And-Implications
3 https://www.heavyliftpfi.com/from-the-magazine/eu-ets-rollout-to-brings-shipping-cost-hike/22600.article
4 https://www.refinitiv.com/perspectives/market-insights/how-ukraine-transformed-commodity-markets-in-2022/
5 https://www.instituteforenergyresearch.org/international-issues/carbon-permit-price-in-europe-hits-100-euros/

comparison with the 'real' cost of the EU ETS. There are risks to customers in:

1. paying in excess of the market value for an emissions surcharge and generating a profit for carriers; or
2. paying below market value for an emissions surcharge in one year, and subsequently facing a larger emissions surcharge the following year to mitigate the shortfall.

Fluctuations in the emissions surcharge over time and between carriers will make it difficult for customers to analyse and get an overview of emissions surcharges across carrier portfolios; making it difficult to manage their volume allocations and estimated spend going forward.

Avoiding the Emissions Surcharge

Of course, another potential outcome is that customers may opt to avoid shipping some of their goods on voyages subject to an emissions surcharge by either:

1. Varying the Routing

Customers may ship goods via a different carrier and/or service, or even a different mode of transport where feasible, to minimise or avoid an emissions surcharge by electing for a service where the last port of call is outside the EU. If there is modal shift to road or rail from sea, this will clearly undermine the objective of the EU ETS.

When a vessel sails to or from an EU port from faraway (e.g. the Americas or Far East etc.) introducing a port of call closer to the EU will reduce the EUAs needed to be surrendered for that voyage, as the EU ETS only looks at the last port of call when calculating the GHG emissions. Of course, customers should remember that certain designated non-EU transhipment ports within 300 nm of an EU port will be considered an EU port under the EU ETS. At present, only the Port of Tanger-Med in Morocco and Port Said East in Egypt have been designated as such.

This approach should, in theory, minimise the extent of the emissions surcharge (if carriers elect to pass on savings to their customers).

2. 'Green Carrier' Programmes and Incentives

Some carriers have announced that customers paying for green fuel programmes (whereby fossil fuels are blended with biofuels or alternative 'cleaner' fuels used to reduce GHG emissions) would not be subject to an emissions surcharge. For example, see Maersk's ECO Delivery and Hapag-Lloyd's Ship Green services.

Commentary

It is still not yet clear how emissions surcharges will be adjusted over time for customers, to accurately reflect the introduction of the EU ETS and increased costs which carriers will face. However, it is clear that the emissions surcharge will vary from carrier to carrier, and across different services in much the same way as bunker adjustment factors currently do. It is hoped that more 'green carrier' programmes will develop and parties will not seek to work around the EU ETS by revising routings.

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