BLOG

Waves Over the Bow: Climate Regulations on a New Tack

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The global shipping industry produces 3% of global annual carbon emissions and is now beginning to feel the heat as pressure mounts for it to reduce greenhouse gas emissions to a net-zero goal by 2050. Industry efforts to date have been led by the International Maritime Organization (IMO). These efforts have, however, lagged far behind other industries. Recent reports and measures taken by various governments suggest that the global shipping industry may need more aggressive measures to reduce emissions and enhance sustainability to ward off government intervention. But any such measures will not be without potential risks.

Background

The United Nations Intergovernmental Panel on Climate Change recently published its Sixth Assessment Report. This report concluded that “human influence has warmed the atmosphere, ocean, and land,” and “limiting human-induced global warming to a specific level requires limiting cumulative CO2 emissions, reaching at least net zero CO2 emissions, along with strong reductions in other greenhouse gas emissions.”[1] This report continues to fuel debate about policies that governments might pursue to reduce global greenhouse gas emissions.

The global ocean shipping industry has long deployed the strategy of staying out of the spotlight with regard to environmental and climate crisis-related controversies, often successfully. Part of this strategy leverages open registries, or “flags of convenience.” These flag states tend to regulate their flagged fleets to the minimum measures required by international maritime law under the oversight of the IMO. From time to time, especially in an environment of record-high profits such as those enjoyed by liner companies over the 2020-2021 time period,[2] regulators have begun to express a fresh interest in the shipping industry. Moreover, according to the UN, the shipping industry accounts for “about 80% of the volume of global trade and is directly responsible for approximately 3% of global greenhouse (GHG) emissions.”[3]

Forthcoming Maritime Regulatory Changes

In recent years, the IMO—which is responsive to open registry nations with jurisdiction over the vast majority of the world’s tonnage—has begun steps to “decarbonize” ocean shipping fleets by the end of the century. Measures agreed to in November 2020 and June 2021 will pursue a 40% cut in carbon intensity across the global fleet by 2030. This leads toward an ultimate goal of total decarbonization after 2050.

The IMO's adopted revision of the international treaty, MARPOL Annex VI, requires increased data reporting and minimal emissions reductions through two measures: carbon intensity reduction requirement (CI) and Energy Efficiency Existing Ship Index (EEXI). The measures apply to all cargo and cruise vessels above a specific gross tonnage trading internationally and registered in a treaty-signatory country. They enter into force in November 2022 and will be reviewed for effectiveness in 2026.

The first measure, CI, is a reduction requirement. This measure requires that shipowners annually calculate a CI for each ship in their possession, considering cargo actually carried. Shipowners must also craft a plan to cut CI to reach annual ship-specific targets. Finally, the relevant flag state authorities in the country where the ship is registered must compare a ship's reported CI to its target, produce a rating, and require a corrective plan if a ship's rating is too low. To date, the CI reduction requirement is "expected to achieve a reduction fleet-wide in compliant ships of about 11% from 2019 levels by 2026." The IMO stated that this is aligned with its 2018 initial GHG strategy to target a sector-wide carbon intensity reduction of 40% between 2008 and 2030, on its way to a 50% GHG emissions cut by 2050.

Additionally, the IMO adopted the EEXI, a goal-based technical measure of existing vessels similar to the Energy Efficiency Design Index (EEDI).[4] Because the shipping industry relies on exceptionally high-cost, long-life capital assets, change is necessarily implemented on a phased-in basis. The amendments are expected to enter into force in November 2022. Shipowners must also ensure their ships are surveyed annually by classification societies using the EEXI. Shipowners and operators have until January 1, 2023 to investigate the options to reduce fuel consumption by their ships' engines. The first annual EEXI and CII reports will be due that year. The first annual reporting on carbon intensity will be completed in 2023, and the first ratings will be in 2024.

International Response by Governments and Shipping Organizations

While the International Chamber of Shipping and other industry groups have lauded the IMO's decarbonization efforts, environmental groups have expressed impatience with the IMO's plans. That impatience appears to be shared by the current U.S. Government. The Biden Administration immediately embraced the Paris Climate Accords and has expressed an interest in adopting a "whole of government" approach to climate change.[5] While the U.S. and European Union are not large flag states for registered tonnage, each has the ability to regulate open registry vessels through the IMO as a major "port state." By that status, each can control who can access those markets. Port state control has long been a lever to protect the environment and ensure that minimum vessel safety standards are not less than the prevailing international law adopted by otherwise lightly regulated vessels.

Members of the European Union delegation to the IMO have also said that the IMO missed the opportunity to lead. In 2015, EU representatives expressed an interest in creating an emissions trading system (ETS) in at least the EU by 2022, with the possibility of additional bilateral greenhouse gas emission rules aimed at the maritime industry. The EU Parliament voted in 2017 to include shipping in the regional ETS. This has been viewed in some quarters as a stick to get the IMO moving on decarbonization. The EU is likely to find common interest in the Biden Administration.

Response by Industry Members

Generally, ocean carrier stakeholders favor uniform, across-the-board global regulation. The rationale is that uniformity helps keep at bay bilateral or unilateral measures. While new IMO regulations may not necessarily be desired, it is more tolerable to have one baseline regime under which all must compete. A patchwork of unevenly applied rules, once proliferated on a country (or even port) level, can be impossible to track and comply with. Some vessel operators have visits in hundreds of jurisdictions on any given day. Rather than risk this, carriers may accept more aggressive regulation promulgated by the IMO.

Leading container carrier Maersk A/S has indicated it intends to exceed the IMO rules. Maersk announced an intent to achieve net zero carbon emissions by 2050, with an interim target of a 60% reduction by 2030. Other maritime companies have similarly announced voluntary climate, environmental, or sustainability goals in annual sustainability reports and other publications.

Even these "voluntary" efforts by maritime companies to reduce GHG emissions are not without potential legal and compliance risks. In the United States, numerous federal regulatory agencies that are not traditionally associated with environmental enforcement are entering the scene.[6] The SEC, FTC, DOJ, and other federal agencies are examining "voluntary" corporate disclosures and marketing about climate change, sustainability, and other Environmental, Social, and Governance (ESG) matters.[7] EU, UK, and Australian financial regulators are performing similarly. These regulators have already fired warning shots that many ESG and climate-related statements are not supported; investigations are underway. Growing evidence suggests that many companies' "voluntary" climate and sustainability claims may be overstated or unsubstantiated. This would subject these entities to legal and compliance risks under various financial, competition, and other statutory schemes. Private litigants are likewise beginning to pursue litigation based on climate-related, sustainability, and other environmental statements and claims.

KEY TAKEAWAYS

- The maritime industry is a source of significant greenhouse gas emissions. National governments are taking note.
- IMO standards to enhance efficiency and reduce greenhouse gas emissions are not scheduled to take effect until November 2022.
- Many maritime companies are setting "voluntary" emission reduction goals and are announcing "sustainability" achievements—often spurred on by investors, lenders, insurance, or other stakeholder pressures; these entities are, likewise, under pressure to change their business practices.
- Voluntary climate, sustainability, and other ESG claims and reports are themselves growing sources of legal and compliance risks. Investigations into ESG claims are underway at the FTC, SEC, and DOJ, as well as other regulators.
- Maritime entities making or contemplating climate, sustainability, and other ESG claims should review diligence, substantiation, and compliance mechanisms to ensure they are sufficient to respond to growing government scrutiny.

For questions related to maritime and global shipping regulations, please contact Bryant E. Gardner (BGardner@winston.com) or Allison N. Skopec (ASkopec@winston.com). For questions related to climate and ESG disclosure, please contact Jonathan D. Brightbill (JBrightbill@winston.com).

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[1] Intergovernmental Panel on Climate Change, Sixth Assessment Report, Headline Statements from the Summary for Policymakers (Aug. 9, 2021), https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_Headline_Statements.pdf.

[2] *See, e.g.*, Greg Knowler, Journal of Commerce online, *ONE Posts Record $3.48 Billion Net Earnings in FY 2020* (Apr. 30, 2021), https://www.joc.com/maritime-news/one-posts-record-348-billion-net-earnings-fy-2020_20210430.html ("The combined operating profit of the nine major carriers that publicly report financial information reached $15.1 billion in 2020, up from $4.8 billion in 2019, on revenues that increased 6.5 percent to $128 billion, according to Alphaliner.").

[3] United Nations Conference on Trade and Development, *Review of Maritime Transport 2018*, https://unctad.org/system/files/official-document/rmt2018_en.pdf.

[4] The EEDI has been mandatory for new vessels since 2013.

[5] Executive Order on Tackling the Climate Crisis at Home and Abroad (Jan. 27, 2021), https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/27/executive-order-on-tackling-the-climate-crisis-at-home-and-abroad/ (In another measure indicating its seriousness on the topic of climate change, the Biden Administration "created a new Presidentially appointed position, the Special Presidential Envoy for Climate, to elevate the issue of climate change and underscore the commitment my Administration will make toward addressing it.").

[6] Winston & Strawn Government Program Fraud, False Claims Act & Qui Tam Litigation Playbook, Co-Author: Financial Risks – Compliance and Risk Considerations (Jun. 1, 2021).

[7] Winston's Environmental Law Update, *Government Enforcers Ramp Up Climate and ESG Claim Investigation* (Sept. 7, 2021), https://www.winston.com/en/winston-and-the-legal-environment/government-enforcers-ramp-up-climate-and-esg-claim-investigation.html .

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Jonathan D. Brightbill

Bryant Gardner

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Jonathan D. Brightbill

Bryant Gardner

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