Council of the European Union

Brussels, 30 September 2022
(OR. en)

13017/22

LIMITE

MAR 168
OMI 83
ENV 938
CLIMA 476

COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	29 September 2022
To:	General Secretariat of the Council
No. Cion doc.:	SWD(2022) 327 final
Subject:	COMMISSION STAFF WORKING DOCUMENT Union submission to the International Maritime Organisation's (IMO) 13th Intersessional Working Group on Reduction of GHG Emissions from Ships suggesting a combination of technical and market-based mid-term measures illustrated by combining the GHG Fuel Standard and a levy

Delegations will find attached document SWD(2022) 327 final.

Encl.: SWD(2022) 327 final

EUROPEAN
COMMISSION

Brussels, 29.9.2022
SWD(2022) 327 final

COMMISSION STAFF WORKING DOCUMENT

Union submission to the International Maritime Organisation's (IMO) 13th Intersessional Working Group on Reduction of GHG Emissions from Ships suggesting a combination of technical and market-based mid-term measures illustrated by combining the GHG Fuel Standard and a levy

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PURPOSE

This Staff Working Document contains a draft Union submission to the International Maritime Organization's (IMO) 13th Intersessional Working Group on Reduction of GHG Emissions from Ships. The IMO has indicatively scheduled ISWG-GHG 13 from 5 to 9 December 2022.

The draft submission provides the advantages of combining a technical and a market-based measure and suggests some core elements that should be included in a combination proposal. It also analyses how a combination of the GHG Fuel Standard (GFS) and a levy could be designed. In addition, the document examines how to allocate revenues and suggests the working arrangements and the structure of a possible IMO Climate Transition Fund.

EU COMPETENCE

Regulation (EU) 2015/757[1] (EU MRV Regulation) establishes the legal framework for an EU system to monitor, report and verify (MRV) CO_2 emissions and energy efficiency from shipping. The regulation aims to deliver robust and verifiable CO_2 emissions data, inform policy makers and stimulate the market uptake of energy efficient technologies and behaviours. It does so by addressing market barriers such as the lack of information. It entered into force on 1 July 2015.

Any IMO measure on GHG matters, which will unequivocally require the monitoring, verification and reporting of GHG emissions from shipping, would affect the EU MRV Regulation. Therefore, the EU has exclusive external competence for GHG emissions in shipping.

Beyond this, the EU Climate Law[2] sets a binding Union climate target of a reduction of net greenhouse gas emissions—emissions after deduction of removals—by at least 55% by 2030 compared to 1990. It also includes the aim of climate neutrality by 2050 and an aspirational goal for net negative emissions after this time.

In addition, on 14 July 2021, the Commission adopted the *Fit for 55* package of proposals to reduce GHG emissions. *Fit for 55* includes a number of Commission's proposals that specifically target the shipping sector. This comprises the revision of the EU Emission Trading System (ETS)[3] to include the maritime transport sector (and the corresponding amendments to the EU MRV Regulation).

Fit for 55 also contains the FuelEU maritime proposal[4], which focuses on the use of renewable and low-carbon fuels in the maritime sector and mandates their uptake by ships calling at EU ports. According to the case-law[5] of the Court of Justice, the risk of affectation concerns not only the rules as they stand, but also their foreseeable future development.

[1] Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport, and amending Directive 2009/16/EC, OJ L 123, 19.5.2015, p. 55–76

[2] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law'); OJ L 243, 9.7.2021, p. 1–17

[3] COM(2021) 551 - Proposal for a directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757

[4] COM(2021) 562 - Proposal for a regulation of the European Parliament and of the Council on the use of renewable and low-carbon fuels in maritime transport and amending Directive 2009/16/EC.

[5] Opinion 1/03 of the Court of Justice of 7 February 2006, Lugano Convention, point 126.

In light of all of the above, the present draft Union submission falls under EU exclusive competence.[6] This Staff Working Document is presented to establish an EU position on the matter and to transmit the document to the IMO prior to the required deadline of 21 October.

[6] An EU position under Article 218(9) TFEU is to be established in due time should the IMO Marine Environment Protection Committee eventually be called upon to adopt an act having legal effects as regards the subject matter of the said draft Union submission. The concept of '*acts having legal effects*' includes acts that have legal effects by virtue of the rules of international law governing the body in question. It also includes instruments that do not have a binding effect under international law, but that are '*capable of decisively influencing the content of the legislation adopted by the EU legislature*' (Case C-399/12 Germany v Council (OIV), ECLI:EU:C:2014:2258, paragraphs 61-64). The present submission, however, does not produce legal effects and thus the procedure for Article 218(9) TFEU is not applied.

INTERSESSIONAL MEETING OF THE
WORKING GROUP ON REDUCTION OF
GHG EMISSIONS FROM SHIPS
13th session
Agenda item XX

ISWG-GHG 13/XX/YY
7 October 2022
Original: ENGLISH
Pre-session public release: ☒

REDUCTION OF GHG EMISSIONS FROM SHIPS

Combination of technical and market-based mid-term measures illustrated by combining the GHG Fuel Standard and a levy

Submitted by Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the European Commission acting jointly in the interest of the European Union

SUMMARY

Executive summary:	The submission provides the advantages of combining a technical and a market-based measure and suggests some core elements that should be included in a combination proposal. It also analyses how a combination of the GHG Fuel Standard (GFS) and a levy could be designed. In addition, the document examines how to allocate revenues and suggests the working arrangements and the structure of an eventual IMO Climate Transition Fund.
Strategic direction, if applicable:	3
Output:	3.2
Action to be taken:	25
Related documents:	ISWG-GHG 12/3/5

Introduction

1 The IPCC AR6 report highlights the need for urgent mitigation action in all sectors to meet the climate targets. In the shipping sector, urgent action to meeting the climate targets is required, in particular at global level in the form of adoption of technical and market based measures as soon as possible. Technical and economic measures are necessary to ensure the acceleration of the green transition of shipping by incentivizing the production and use of renewable fuels, as well as the rapid uptake of energy efficiency solutions. To address the important challenges ahead there is a need for stronger incentives to stimulate the climate transition as well as building up revenue for supporting adaptation and facilitating a just and equitable transition.

2 MEPC78 concluded that *"ISWG-GHG 12 had finalized the consideration of the various proposals for mid-term measures under phase I of the Work plan for the development of mid-term measures and was now advancing to further development of a "basket of candidate mid-term measures" under phase II of the Work plan."* .

3 Phase II of the Work plan requires the assessment and selection of measures to be prioritized for further development in phase III. Comprehensive understanding of the measures is needed, in particular on their feasibility, effectiveness to deliver on the long term levels of ambition of the strategy and their potential impacts on states.

Core elements ensuring the achievements of our common objectives

4 The Mid-term Measures (MTMs) need to ensure that emissions of international shipping are reduced following a pathway consistent with the revised IMO GHG Strategy and that the fuel transition towards the use of zero emission fuels starts already during this decade. At the same time, MTMs should address disproportionately negative impacts as appropriate and facilitate the transition to a decarbonised shipping sector in a just and equitable way. Even though some measures may be able to ensure meeting the reduction targets in the revised strategy on their own, individual measures will have shortcomings and may not be able to address all of these aspects. Therefore, it is the view of the co-sponsors that a combination of measures would more effectively serve the fulfilment of the above-mentioned goals of MTMs.

5 It is important that future IMO climate regulations first and foremost address the need to swiftly reduce GHG emissions in line with the objectives of the revised Strategy and also satisfy the needs of the shipping sector as well as a just and equitable transition. Therefore, in order to pave the way for an effective decision-making process, the co-sponsors consider it important to first consider a set of principles for the Market-based Measures, before any possible combination of mid-term measures can be selected. This will allow for assessing and selecting those measures, which are not only feasible and equitable but also effective and efficient in achieving the necessary level of ambition of a revised IMO GHG Strategy. These measures should then be further developed.

6 In MEPC 77/7/12 by Austria et al. a set of nine guiding principles for Market-based Measures (MBM) were suggested as a the basis on which any proposal for a carbon pricing measure should be evaluated. The principles are a revision of the principles agreed at MEPC57 and most of these principles would also apply to evaluation of a technical measure. The nine guiding principles addressed principles on

.1 MBMs should create a significantly effective, clear and measurable response to the climate emergency in the form of reduced GHG emissions;
.2 MBMs should place a price on GHG emissions following the "polluter pays principle" and provide an economic incentive for the maritime industry to reduce their GHG emissions;
.3 MBMs should send a clear signal to the market on the future regulation and timetable of decarbonization. This would provide clear long-term price trajectory aiming at initiating the use of renewable low- and zero-GHG fuels in international shipping by the middle of the decade and then steadily increasing their use in international shipping;
.4 MBMs should be goal-based with the aim of encouraging fuels and technologies that provide for effective emissions reduction;
.5 the administration of MBMs should be transparent, effective, easy to implement and enforceable to prevent fraud;
.6 MBMs should be designed to be flag-neutral and they should ensure equal treatment of all operators;
.7 MBMs should be cost-effective;
.8 MBMs should not be duplicative. In case of any national or regional action by Member States to further accelerate GHG emission reduction from shipping, double counting of CO_2eq emissions should be avoided; and

.9 for revenues generated from MBMs, significant shares of resulting funds should be used to support maritime climate mitigation and adaptation activities, in particular in developing countries, in order to ensure a globally effective and equitable transition.

7 To make the principles more specific and applicable to a combination of measures, the co-sponsors would like to suggest that the following core elements based on the guiding principles are included in future proposals for combination of measures. The core elements are as follows:

- The combination of measures leads to a clear and predictable pathway for reduction of GHG emission from shipping in line with the agreed levels of ambition of the revised IMO GHG strategy and consistent with the Paris Agreement temperature goals including the aim to limit the temperature increase to 1.5°C.
- The combination of measures facilitates an immediate start of the fuel transition and early uptake to ensure that emission reduction targets and checkpoints are met.
- The combination of measures ensures that shipping emissions do not lead to increased emissions in other sectors. Therefore, the combination is based on full life cycle assessment of emissions (Well to Wake approach, WtW).
- The combination of measures includes an economic incentive component, with the objective to send a price signal for the industry to decarbonize and to generate revenues, inter alia to support a just and equitable transition.

8 In order to fulfil all these core elements, the co-sponsors argue that the Greenhouse Gas Fuel Standard (GFS), as proposed in ISWG 13/X/X, should be complemented by a market-based measure. ISWG-GHG 12/3/5 by Austria et al. analyses the characteristics and added value of a combination of the GFS with a carbon pricing measure in the form of a levy-based scheme or an emission cap-and-trade scheme. Building on the core elements, the main arguments by the co-sponsors for a combination of the GFS with an MBM are:

- In the combination, the GFS would drive the decarbonisation by a gradual reduction of the average fuel GHG intensity, to allow for a rapid implementation and uptake of low- and zero-GHG fuels and technologies based on a WtW perspective on emissions from fuels. This is important because the overall emission reduction goal requires that the fuel transition starts as soon as possible in view of the goal to phase out GHG emissions from shipping by 2050 at the latest. This is the main goal of the GFS.
- An MBM would supplement and accelerate the effect of the GFS. It would provide an economic incentive to further support the production and use of renewable fuels as well as to further improve energy efficiency. The combination of a GFS with an MBM can thereby spur early uptake of low- and zero-GHG fuels. At the same time, an MBM would generate stable stream of revenues that may be used to, inter alia, support R&D, incentivize the uptake and improve availability of low- and zero-GHG fuels and solutions as well as to ensure a fair and equitable transition in Small Island Developing States (SIDS) and Least Developed Countries (LDCs). Revenues could also address possible disproportionate negative impacts. Addressing a just and equitable transition to a decarbonised shipping sector comprises initiatives that increase the availability of fuels, investments in ships and infrastructure as well as improve technical cooperation and access to technology.
- Taken together, a GFS and an MBM can be set in order to provide certainty about emission reductions according to a predictable timeline in line with the levels of ambition of the revised IMO GHG strategy. Thus, it provides predictability to investors, both in the shipping sector and in the land based energy sector.

Combination of the GFS with a levy

9 This submission investigates the case for a combination of the GFS and uses as an illustrative case a levy-based system which fulfils all three core elements. The co-sponsors recognize that the GFS could also be a good basis for combinations with other MBMs e.g. an emission cap and trade system (ECTS) which could also address all core elements.

10 ISWG 12/3/5 by Austria et al. described various advantages and shortcomings by combining the GFS with a levy compared to other MBMs. The main advantages of a combination with GFS and a levy are summarized below:

- Transparent and stable emission pricing providing clear economic incentive for the sector (greater predictability on investments in climate transition)
- Simple administration for both industry and authorities
- Predictable and stable revenues to meet the core elements
- Stable economic incentives for the early uptake of low GHG fuels and improved energy efficiency
- The levy does not need to bridge the full price gap between conventional and low- and zero-GHG fuels, which leaves room for a lower levy without compromising the reduction target.

11 A levy combined with a GFS can ensure phasing-out GHG emissions, but their levels may need to be adjusted with changing volumes of shipping activity and achieved level of emission reduction, to ensure a stable and certain emission reduction trajectory.

Design of a levy as part of the combination

12 The levy should apply to all new and existing ships, which are required to submit fuel oil consumption data to the IMO DCS - currently ships above 5000 GT operating internationally. A potentially lower threshold (e.g. 400 GT) may be explored upon adoption of the regulation.

13 The basis of the levy would be the WtW GHG ($CO2_{eq}$) emissions of the fuel used onboard a ship as reported to the IMO Fuel Oil Consumption Data Collection System (DCS). The basis of the levy would not be impacted by the potential use of a surplus reward mechanism under the GFS. The levy price would be expressed as a price per ton of $CO2_{eq}$ emissions. The total amount of levy to be paid can be calculated by multiplying the levy with the total $CO2_{eq}$ emissions of a ship.

14 On a yearly basis, the total amount of reported bunkered fuels should be verified based on the DCS fuel oil consumption data to check whether all Bunker Delivery Notes (BDN) have been reported. The amount of the bunkered fuel should be complemented with the LCA WtT CO_{2eq} value of that fuel, as well as the TtW CO_{2eq} value, taking into account the specific vessel efficiency.

15 The possible need for articulation of such levy with national/regional systems for pricing GHG emissions will have to be considered at a later stage during the development of the measure, keeping in mind the need to avoid any significant double burden.

16 The levy price can be adjusted over time to ensure the economic incentives are fit for purpose and meet the demand for revenues, and could for example be set in 5-years intervals.

The IMO Climate Transition Fund (ICTF)

17 An establishment of an IMO Climate Transition Fund (ICTF) under the auspices of IMO as described in Annex 1 could be an appropriate vehicle to collect the total amount of the revenues generated by the levy based on the data reported to DCS as described in para 12 and 13 as well as to administrate the Fund, without prejudice to possible delegation of the management of some parts of the revenues collected to other entities than the ICTF itself, as explained in paragraph 22 below. The operations of the Fund would be guided by the principles of the IMO GHG Strategy and provisions of MARPOL Annex VI. The Fund would operate in a transparent and accountable manner guided by efficiency and effectiveness[7]. For this reason, clear charter for the fund operation should be established. The charter should be approved with broad support among IMO members.

18 The ICTF should be governed and supervised by a Board consisting of an equal number of developing and developed countries that will have full responsibility for funding decisions. In addition, the ICTF should be supported by a specific service within the IMO Secretariat.

19 Under the ICTF the calculated levy payment will be verified based on the data collected for DCS purposes and a Statement of Compliance (SoC) issued once the full payment has been received, which is valid until June 30th the following year. The only task for the flag State and port State control would be to monitor that the ship carries on board a valid SoC and payment of the levy under the ICTF, and thereby documenting that ships are eligible to operate. ICTF could publish a list with vessels that already paid as well as vessels for which the payment is still pending.

20 The company owning the ship (as stated by the ISM Code) is the ultimate responsible for the payment of the levy. Companies and operators are free on contractual level to delegate the payment of the levy to a charterer or claim reimbursement from the entity that is directly responsible for the decisions affecting the emissions of the ship (charterer) according to the polluter pays principle.

How to allocate and distribute revenues

21 Allocation of the collected funds could be used for the following purposes:

- Shipping related climate transition. This includes among others projects and initiatives, which improve port and maritime infrastructure, increase investments in production of renewable marine fuels or reward first movers and/or facilitates early uptake of green marine fuels.
- Maritime climate transition and adaptation measures in SIDS and LDCs. This includes funds for maritime capacity building, technical cooperation, infrastructure for fuel production and e.g. maritime related climate projects and initiatives. Some of the projects and initiatives may be accounted for in the general climate obligations
- Projects and initiatives addressing possible disproportionate negative impacts on states in developing countries, as appropriate. Some of the projects and initiatives may be accounted for in the general climate obligations
- Maritime R&D, demonstration projects etc. which improve the technology and commercial readiness level of relevant climate technologies for shipping and fuels.

[7] Proposal for design of IMRB as well as UN funds like GCF may serve as inspiration.

- Administration of the Fund. The ICTF should be established, managed and operated without cost to the IMO, and once the Fund is operational, costs including start-up costs can be recovered from the levy.

22 The allocation of revenues may take the form of subsidies, financial instruments, or other instruments approved in the charter of the ICTF, whilst preventing distortion of competition. As a general rule, the Board of ICTF should delegate administration of parts or entirety of the funds to existing dedicated international financial institutions (e.g. such as multilateral development banks) or dedicated UN climate funds e.g. the GCF under the Paris Agreement, where appropriate and in particular for facilitating a just and equitable transition, or for addressing possible disproportionate negative impacts on states, and to facilitate the effective, efficient and transparent handling of revenues. The allocation within each purpose category and across the ICTF operation may change over time as the transition progress and transition needs change. In particular, change in relative allocation across the different purposes should be decided by MEPC following the decision process for amendments to MARPOL Annex VI.

23 The board of ICTF should aim at ensuring a fair allocation of funds, which takes into account both the geographic distribution and a particular attention to access of funds for SIDS and LDCs.

Conclusion

24 This proposal illustrates how – based on core elements - a combination of a GFS and an MBM, using the example of a levy-based system, can be designed to:

- compensate the short-comings of a single measure
- meet the necessary climate targets of the IMO GHG Strategy
- address a just and equitable climate transition
- collect sufficient and predictable revenues to spur the transition without necessarily having to set a levy which bridges the full price gap between fossil and renewable low- and zero-GHG fuels.

Action requested by the Working Group

25 The Working Group is invited to consider the illustrated combination of GFS and an MBM, using the example of a levy-based system, including the core elements for further investigation in the negotiation on MTMs in Phase II of the work plan.

Annex 1 - Example of an IMO Climate Transition Fund design

A1 The purpose of an IMO Climate Fund is to facilitate the maritime climate transition. This is done by:

1) verifying and collecting a levy and
2) distributing/allocating the revenues according to the purposes described above in para 21 and 22, and
3) monitoring projects and initiatives funded by the ICTF.

A2 The ICTF should be established in connection with the IMO headquarters, with a dedicated Board, supported by a separate division under the IMO Secretariat.

A3 The Board consist of 24 members composed of an equal number of members from developing and developed country Parties. Parties will include representatives from small island developing States (SIDS) and least developed countries (LDCs). Board members are designated by MEPC. Board members and chairperson are nominated based on relevant professional quality and are elected for a period of three years and serve for a maximum of six years.

A4 The Fund will be governed and supervised by a Board that will have full responsibility for funding decisions. Decisions of the Board will be taken by consensus of the Board members, disengaging board members with potential conflicts of interest. The MEPC will establish procedures for adopting decisions in the event that all efforts at reaching consensus have been exhausted. The Board decisions on allocation of funds for projects and initiatives are taken at board meetings based on decision-making proposals from the IMO Secretariat.

A5 As a general rule, the Board should allocate the funds to be administered allocated by already established international organisation within the scope of and charter governing the ICTF. It may delegate decision on projects below a certain financial threshold to the management of the IMO Secretariat.

A6 The team of IMO Secretariat will be fully independent. The team of the IMO Secretariat will serve and be accountable to the Board. It should have effective management capabilities to execute the day-to-day operations of the ICTF.

A7 MEPC is responsible for general oversight of the activities. IMO Council is responsible of governance and annual budget of the ICTF. The Board is requested to submit an externally audited annual report for approval by the IMO Council. The report should cover the Fund's operations, budget, risks, results, strategy and can be accompanied with possible proposals for changes in funds mandate and operations. Furthermore, MEPC is responsible for establishing independent audit of the Fund.

A8 MEPC and the IMO Council should establish a Charter for the establishment and governance of the IMO Climate Fund. The Fund governance should follow common UN standards, incl. the UN Convention Against Corruption. Amendments to the Charter can be decided by MEPC following the same procedure as for amendments to MARPOL Annex VI.

A9 Unallocated funds can in the case of insufficient eligible projects be forwarded to future years. The revenue collection will stop when the entire sector is using zero emission fuels, but the Fund will be able to continue its operation according to its purpose until all funds have been allocated. After that, the Fund will cease operations.