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WILL "MAGIC FUEL" BE THE NEXT "MAGIC PIPE"? ALASKAN FEDERAL EMISSIONS CONTROL AREA LAWSUIT RAISES QUESTIONS ABOUT INDUSTRY EXPOSURE UNDER NEW RULES

Introduction and Background

In a lawsuit that raises unique questions about international and federal law, the State of Alaska is seeking an injunction against the Federal government which, if granted, would prevent Federal agencies from enforcing an offshore segment of the newly created North American Emissions Control Area (ECA). The case, which is the first of its kind involving new international standards and corresponding U.S. laws that came into effect in August 2012, argues that Environmental Protection Agency (EPA) regulations requiring ships transiting the area of the ECA off of Alaska's coast to burn lower sulfur fuel will have the practical effect of an additional corporate tax on the shipping and tourism industries so vital to Alaska's economy. According to Alaska, the additional costs of complying with the ECA, which encompasses areas off of the southeastern and central parts of Alaska that include shipping routes, will ultimately be passed on to the consumer, making the already high cost of shipping goods to the state and the cruise ship passenger fares even more expensive.

The suit is one of the latest developments in the government's "phased" approach to cutting sulfur emissions that has seen some states, like California, seek tighter regulation of maritime emissions, and others, like Alaska, seek fewer restrictions. Although the immediate impacts of the case may not be recognized by the broader shipping industry, the dispute underscores the varied reactions state governments and industry are having to the new federal emission requirements, and highlights the processes employed by the federal government in applying and enforcing international standards in areas that extend beyond U.S. territorial waters. Regardless of the outcome of the case, two things are very clear: (1) increasingly stricter air emissions requirements for ships, in some shape or form, are here to stay, and (2) the Federal government is serious about enforcing them. As a matter of fact, the first known U.S. citation for ECA related deficiencies occurred in early February of this year, when a Panamanian flagged bulk carrier was issued two operational deficiencies in New Orleans by the U.S. Coast Guard. According to the Coast Guard's Port State Control Report, the vessel had compliant fuel onboard, but failed to use it while operating in the North American ECA, and both the Master and Chief Engineer were not familiar with the operation of Annex VI related equipment and the current ECA rules. While there has been no report of any subsequent criminal investigation of the vessel or her crew, this incident signals that U.S. inspectors are actively paying attention to vessel compliance with the new ECA and low sulfur fuel standards and will be on the lookout for violations.

Similarities in the recordkeeping requirements of Annex VI to those employed in respect to MARPOL[1] Annex I (prevention of oil pollution) and Annex V (garbage management), when coupled with the U.S. government's aggressive pursuit of maritime environmental crimes cases, makes one wonder: will the stricter fuel requirements expose vessels and vessel interests to criminal and civil liability the way oily water separator ("OWS") cases have to date? After all, in the

last five years alone, U.S. criminal investigations and prosecutions of alleged OWS related misconduct and Oil Record Book log entries have resulted in millions of dollars in criminal fines and community service payments, and thousands of months of criminal probation for vessel owners and operators, including the mandatory implementation of expensive environmental compliance monitoring programs by many of these entities for their fleets.

Moreover, the very same statute relied upon by the U.S. government for the investigation and prosecution of suspected MARPOL Annex I (oil) and V (garbage) violations also governs Annex VI. The U.S. Act to Prevent Pollution from Ships (commonly referred to as the "APPS") implements all of the international MARPOL treaty and its Protocol, outlining among other things the administration and enforcement of MARPOL, issuance of certificates, reporting requirements, violations, and penalties for violations of the APPS. The APPS provides for both civil and criminal penalties, making the knowing violation of the APPS a Class D felony.

The APPS, for the most part, provides inspection, examination and investigation authority for suspected violations of the Act to two agencies: the U.S. Coast Guard, and the EPA. In 2011, the two agencies entered into a non-binding Memorandum of Understanding to establish how they would mutually implement and enforce the newly created ECAs, including the referral of violations and evidence from one agency to another and the provision of relevant technical expertise. While the EPA has authority to issue Engine International Air Pollution Prevention (EIAPP) certificates, the Coast Guard has law enforcement authority to board ships on the high seas and waters subject to U.S. jurisdiction, as well as certain facilities ashore. The agreement delineates the investigation and enforcement of certain types of violations based upon each agency's expertise and authority.

In general, suspected violations of MARPOL and the APPS in which there is probable cause to believe a criminal violation has occurred are referred, normally by the Coast Guard, to the Department of Justice for further investigation and prosecution. In the 30 years since the enactment of APPS, U.S. agencies have refined their tactics for investigating suspected APPS matters and improved their coordination, leading to more frequent and successful criminal prosecutions under the statute, which in turn deliver positive publicity and substantial fines to the government. In particular, the U.S. government has increasingly credited the allegations of and relied upon testimony from so called "whistleblowers," who may receive up to half of a criminal fine levied in a criminal APPS case. A mere allegation alone by a whistleblower that a vessel has violated the APPS will, in almost all cases, trigger a lengthy (and costly) investigation by U.S. authorities in port.

With such a the powerful tool at its disposal, substantial incentives for successful APPS prosecutions, and an established statutory framework for handling such matters under the APPS, there is little reason the Coast Guard, EPA and Department of Justice will approach suspected violations of Annex VI under the APPS any differently than those involving the other MARPOL annexes (i.e. oil and garbage).

For their part, there are steps vessels, their owner and operators can take if indeed the current pattern for enforcement of international environmental standards continues. Vessels calling in U.S. waters and at U.S. ports, can expect rigorous scrutiny of their records concerning the purchase and use of compliant fuels. Consequently, owners and

operators should be vigilant about compliance, International Safety Management (ISM) Code policies and procedures, and onboard training of vessel personnel; and, regulated entities such as corporate vessel owners and technical managers, should be knowledgeable about government requirements, policies and options, with a view towards avoiding many of the pitfalls the maritime industry has seen with OWS cases and Oil Record Book requirements.

MARPOL, APPS, ECAs and the New Lower Sulfur Fuel Requirements

When the revised Annex VI to the International Convention to Prevent Maritime Pollution (MARPOL) entered into force in June 2010, new limitations on sulfur oxides, which will progressively increase over the next seven years, were put into place. These measures strive to minimize airborne emissions from ships and, according to the International Maritime Organization (IMO), and are intended to reduce local and global air pollution and environmental issues emanating from vessel emissions through two complementary sets of standards. The first set of new standards imposes a "global cap," applicable at all times, for the sulfur content of fuel (lowering the permissible level of sulfur in fuel from 45,000 parts per million to 35,000). The standards will require cutting sulfur content by an additional 30 percent by 2020.

The second set of new standards in the revised MARPOL treaty, which addresses various forms of maritime pollution such as oil, sewage and garbage, are limited to certain geographic areas, replacing existing sulfur oxide control zones with the new Emissions Control Areas that regulate the emission not only of sulfur oxides but the release of other ozone-depleting substances such as nitrous oxides and particulate matter by vessels within the area.[2] Beginning in August, 2012, ships subject to MARPOL regulations transiting the North American ECA, which extends 200 nautical miles from a substantial portion of both the American and Canadian coastlines, must burn low sulfur fuel oil (not exceeding one percent or 10,000 "parts per million."). In addition to the new North American ECA and existing ECA's in the Baltic and North Seas, another ECA in the Caribbean Sea is slated to enter into force in January 2013 and take effect in 2014 and 2015. In general, by 2015 most ships will have to cut their fuel sulfur standard to .10 percent when operating within ECAs, and by 2020 all ships operating anywhere (i.e. outside of ECAs) must cut their fuel sulfur standard to .5 percent. Increasingly stringent emissions requirements and fuel standards therefore already apply, or will soon apply, to ships whether they are operating inside or outside of a designated ECA.

There are some exceptions, codified in Part 1043 of Title 40, Code of Federal Regulations, to the most recent low sulfur fuel burning requirement. For example, ships can use alternative means of complying with lower emissions standards such as exhaust gas cleaning systems or by retrofitting existing systems with the ability to burn very "clean" fuel, such as Liquefied Natural Gas, if the alternative system is approved by the EPA as an equivalent. Some types of vessels, such as steamships, are categorically exempt from the requirements, but generally the new requirements apply to all vessel types, including recreational vessels.

Moreover, interim guidance published by the EPA attempts to take into account supply issues and the difficulty some vessels will face in obtaining compliant low sulphur fuel by providing the ability to file a "non-availability report" with the vessel's flag administration and the "competent authority" in the port of destination (which in the U.S. is the EPA) no later than 96 hours prior to

entering the ECA.[3] As the EPA notes in its guidance for fuel non-availability, filing such a report does not render a vessel "compliant" or otherwise exclude it from criminal or civil liability – it merely documents the non-availability of compliant fuel as a factor to be taken into consideration by the enforcing agency. The flexibility to use alternative compliance measures and/or file fuel non-availability reports is likely designed to soften the transition to the new standards and their impacts on industry before the more stringent requirements take effect in 2015 and 2020, though the practical effect of using alternative measures and filing such reports is not yet clear.

The new MARPOL Annex VI standards, together with the APPS, also entail a number of recordkeeping obligations for vessels. To demonstrate compliance with the requirements, larger ships on international voyages are required to maintain an Ozone Depleting Substances Record Book and record, among other things, the vessel's position, type of fuel, sulfur content after each bunkering operation, as well as the position, date and time of any fuel-oil-change-over operation prior to entering or after exiting an ECA. Additionally, when a ship is inside an ECA, it must specify in the log book the procedures it uses to comply with the new emissions limits, such as its use of low sulfur content fuel or an exhaust gas cleaning system. Smaller vessels or those on domestic voyages may demonstrate compliance with the lower sulfur requirements by showing marine distillate fuel receipts for fuel purchased in the U.S.

Failure to keep accurate records or, even worse, to conceal non-compliant activity could result in criminal and civil liability under APPS and a potential combination of a number of other U.S. criminal provisions, depending upon the circumstances, including but not limited to:

- The False Statements Act (18 U.S.C. § 1001)
- Conspiracy (18 U.S.C. § 371)
- Sarbanes Oxley (18 U.S.C. § 1519)
- Obstruction of Justice (18 U.S.C. § 1505)
- Witness Tampering (18 U.S.C. § 1512)
- Clean Air Act (42 U.S.C . § 7401 *et seq.*) for U.S. vessels

These offenses have all been utilized, to some degree, in U.S. APPS prosecutions involving OWS bypass, Oil Record book, and/or Garbage Record book allegations. Additionally, the Department of Justice has routinely and successfully indicted vessel owners and operators based upon "vicarious liability," in which the corporation is held liable for the acts and violations of its employees. As discussed below, the criminal fines and other penalties associated with such violations are significant for both vessel owning and/or operating corporate entities and the individual vessel officers and crew employed by them.

The "Cost-Benefit" Factor: Resistance to the New Low Sulfur Fuel Requirements

The federal government's efforts to implement and enforce the new standards have already been met with some resistance. The State of Alaska filed its initial complaint in *State of Alaska v. Clinton et. al* in the U.S. District court in Alaska in July 2012, subsequently amending it two months later to include additional factual allegations and re-characterizing its action as predominantly an Administrative Procedure Act (APA) challenge of the federal government and its

new ECA requirement[4]. The complaint names as Defendants the respective heads of the Department of State, EPA, Department of Homeland Security (DHS) and the U.S. Coast Guard, in their official capacities.

In essence, Alaska argues that the process utilized to create the ECA ran afoul of the law in several respects. First, Alaska contends that the Secretary of State's acceptance of the amendment extending the ECA to waters off Alaskan shores violated the APA as it was "accepted" without adequately supported scientific analysis and therefore arbitrary, capricious, in excess of the APPS or otherwise contrary to law. In other words, the federal government did not meet its burden of proving negative impacts of sulfur oxide and other emissions on the population in Alaska. Alaska further charges that the EPA improperly created the ECA without affording interested persons an opportunity to comment first, through Federal rulemaking, regarding its scope or designation. Finally, raising a Constitutional argument, Alaska contends that the Secretary of State and EPA unilaterally, and improperly, adopted an international measure (the ECA amendment to MARPOL Annex VI) as Federal U.S. law without proper Congressional approval.

As a result of these legal and procedural missteps, the State argues, the economic harm Alaska will suffer will outweigh any "speculative environmental benefits" to be derived from the regulations. Joined by cruise ship industry advocate Resource Development Council, Alaska seeks a judgment declaring that the federal government overstepped its authority when it included the waters off Alaska in the ECA, as well as an injunction that would prevent the Federal government from enforcing the ECA in those waters. The primary "harm" stemming from the Alaskan portion of the ECA is economic: the state argues that enforcement of the ECA off Alaska's coast will drive up the cost of goods within the state, reduce royalty payments and production taxes that the state receives (and depends upon) from oil companies, and hurt tourism by driving up the costs of Alaskan cruises.

The federal government has sought to dismiss the complaint and corresponding request for injunctive relief because, it argues, Alaska has failed to demonstrate that it would succeed on the merits of the case, has not shown irreparable harm by the underlying government actions, and has improperly balanced the financial equities against the public's interest.

In support of its motion to dismiss, the government relies upon economic analyses performed by consultants who, at the government's request, studied the costs and benefits associated with implementing and enforcing the Alaskan portion of the ECA. Using data related to the two primary containerized shipping companies that carry goods into Alaska, including the percentage of transit time inside the disputed portion of the ECA, these consultants concluded that the impact on shipping costs imposed by the ECA was and will be "negligible," the effects on tax and royalty revenues were "overstated" by the State, and the dire consequences on tourism predicted by Alaska are exaggerated. Moreover, the government argues as a general matter that refusal by the U.S. to enforce provisions of a treaty it has signed on to would damage U.S. diplomatic relations and send "mixed signals" to the international community. In addition, a number of environmental groups have intervened in the case and filed briefs in support of the government's motion to dismiss the case. The groups have primarily lodged an additional challenge, which is that the Alaskan complaint was untimely and that venue in Alaskan federal district court is inappropriate. The case should have been brought within 60 days of the issuance of EPA regulations, these

groups argue, and in the District of Columbia district court.

The effects of the anticipated decision in the *State of Alaska v. Clinton et. al case* on shipping, tourism, the general American public and the scope and extent of federal versus state authority, await the judge's ruling, and any appeals that will surely follow. It is unclear whether other states will pursue similar actions in federal court, whether states will continue to take a varied approach to emissions standards, or whether industry representatives will seek to exert political or economic pressure in court or through other avenues to alter the government's plans to phase-in the new emissions control standards. For example, one Canadian-based company is encouraging Canadian and U.S. lawmakers to carve out an exception that would push the ECA requirements 50 miles offshore in order to exempt "shortsea" or "coastal" shipping. Implementation of the new measures, this company argues, will have the counterproductive effect of driving many shippers to use other, more "emissions heavy" non-maritime transport methods, such as railways and trucking. Like the one Alaska now faces in court, such challenges will require a significant reversal in the U.S. diplomatic and regulatory stance in order to be successful.

From "Magic Pipes" to "Magic Fuel?" Enforcement of the New Lower Sulfur Requirements and the Shipping Industry

Regardless of how the Alaskan case plays out over the next several months, it appears the increasingly strict emissions rules and corresponding record keeping requirements are here to stay. First, environmental groups and states like California have been successful at imposing even stricter standards, demonstrating the broad range of views on such measures. Second, the IMO has indicated that success and uniformity will not be realized "overnight" by pledging to assess the availability of low sulfur fuels as the new standards take effect and to adjust regulations accordingly. Third, the federal government has publically disclosed its strategy and intent to enforce the new ECA and lower sulfur fuel requirements, announced through policy guidance posted by the Coast Guard and EPA. This last development serves as a clear signal that the U.S. will be watching ships subject to the new standards to ensure compliance.

The Coast Guard is the agency most likely to detect non-compliance with the emissions control requirements because of its broad maritime law enforcement authority and Port State Control vessel safety and security program, part of which is aimed at detecting and preventing violations of MARPOL and the APPS. In 2011 the Coast Guard reported 9,326 "distinct visits" by vessels subject to its Port State Control program and close to 80,000 vessel calls in the U.S. overall.[5]

Jurisdictional and other legal issues associated with enforcing MARPOL Annex VI and the new ECA requirements bear some resemblance to those encountered with oily water separator (OWS) and Oil Record Book violations (commonly referred to as "magic pipe" cases), which the U.S. Department of Justice continues to aggressively investigate and prosecute. Namely, substantive violations of MARPOL and APPS onboard foreign flagged vessels are subject to U.S. enforcement only if the violation is committed inside waters subject to U.S. jurisdiction. As a result, most APPS violations are prosecuted as felony federal recordkeeping offenses in which the criminal offense is the physical act of presenting an altered or materially false record to U.S. authorities inside U.S. waters or at a U.S. port. The stakes in such cases are high, as corporate entities such as vessel owners and technical managers face large

corporate criminal fines (up to $500,000 per count proven or plead to) for the unlawful acts of their employees, and individual crewmembers face the prospect of jail and other penalties (such as fines of up to $250,000 per count proven or plead to) for substantive violations of APPS and related U.S. criminal laws. Individuals and/or organizations that violate APPS may also be liable for civil penalties of up to $40,000 per violation, separate and apart from any criminal liability.

It comes as no surprise that the Coast Guard has unambiguously conveyed its intent to pursue suspected MARPOL Annex VI and associated recordkeeping violations in an approach similar to suspected "magic pipe" cases. Last July, the Coast Guard posted guidelines, in the form of answers to "frequently asked questions," for incorporating the new MARPOL Annex VI requirements into its overall marine safety inspection, examination and investigation regime, including how it will handle referral of suspected and confirmed MARPOL Annex VI violations.[6] The Coast Guard has indicated that violations by foreign flagged vessels which occur seaward of waters not subject to U.S. jurisdiction will be referred to the vessel's flag administration, but because foreign vessels visiting U.S. ports remain subject to international and U.S. laws related to recordkeeping, the Coast Guard will serve as lead agency for investigating suspected violations of such (i.e. the falsification of a log book). Non-criminal enforcement action will be referred to the EPA, but the Coast Guard noted that it reserves the right to process non-criminal violations under its own policies and penalty procedures. To date, the Coast Guard has not formally promulgated or proposed regulations in the Code of Federal Regulations.

Although it remains to be seen, it is likely that regulated entities such as vessel owners and operators desiring to "self report" suspected and confirmed Annex VI violations onboard their vessels will have the ability to do so under the Coast Guard's "Appendix V" program, as is, under applicable circumstances, the case with other MARPOL and APPS matters, such as cases involving the discharge of oily waste. Because the Coast Guard's current environmental crimes voluntary disclosure policy applies broadly "to criminal violations under all of the Federal environmental statutes that the Coast Guard administers," there is little reason to believe otherwise.

Under the Appendix V policy, entities who maintain compliance management programs to prevent, detect and correct MARPOL violations and who promptly report such violations within 21 days of discovery *may* avoid criminal charges so long as the Coast Guard is satisfied the violation is not part of a pattern or broader practice, does not involve a "prevalent management philosophy or practice that conceals or condones environmental regulations," or does not reveal conscious involvement or disregard by senior management. It is worth noting that because voluntary disclosure is not a literal "get out of jail free" card and involves the consideration of a number of complex factors, an entity's timely consultation with its counsel is important. Similarly, voluntary disclosure of a violation "after the fact" should not be confused with the voluntary filing of a fuel "non-availability" report, which applies *before* a vessel has entered the North American ECA and violated the new rules.

Conclusion

As the parties in *State of Alaska v. Clinton et. al* continue briefing the federal government's motion to dismiss the case and preparing for oral argument on the motion, the shipping industry rightfully continues to adapt to significant changes in the type of fuel ships

burn and the ways they will burn it in the future from both a strategic planning and operational perspective. If U.S. enforcement of MARPOL and APPS matters in other realms, such as Annex I (oil) and Annex V (garbage) provides any sign of how the new Annex VI air emissions standards and associated recordkeeping requirements will be enforced, shipping interests can expect scrutiny of their vessels and detentions in the U.S. for major discrepancies in their logbooks.

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[1] MARPOL is a reference to the International Convention for the Prevention of Pollution from Ships (MARPOL) as amended by the Protocol of 1978 and enacted in the United States by the Act to Prevent Pollution from Ships of 1980 (the "APPS"), which is codified in the U.S. at 33 U.S.C. §§ 1901-1915.

[2] *See generally* MARPOL Annex VI at Regulations 13, 14 and 18; *see also* 40 C.F.R. Part 1043. Information about MARPOL air emissions standards and other International Maritime Organization (IMO) environmental programs and initiatives may be accessed via the IMO website at: http://www.imo.org/OurWork/Environment/ (last visited Feb. 23, 2013).

[3] *See* EPA Memorandum "Interim Guidance on the Non-Availability of Compliant Fuel Oil for the North American Emission Control Are" dated June 26, 2012 (Air Enforcement Division); *see also* MARPOL Annex VI Regulation 18.

[4] The docket for *State of Alaska v. Clinton et al.* may be accessed using the Federal judiciary's Case Management/Electronic Case Files (CM/ECF) system (registration and password required), Civil Case Number 3:12-cv-00142-SLG.

[5] *See* U.S. Coast Guard Port State Control Annual Report for 2011 (dated August 23, 2012), available at: https://homeport.uscg.mil/mycg/portal/ep/contentView.do?contentTypeId=2&channelId=-18371&contentId=65744&programId=13086&programPage=%2Fep%2Fprogram%2Feditorial.jsp&pageTypeId=0&BV_SessionID=@@@@1485114913.1362150414@@@@&BV_EngineID=ccccadfjemmhkeecfngcfkmdfhfdfgo.0. ***Editors note:*** *the 2011 Annual Report provides the latest figures publicly available, as the Coast Guard at the time of this writing has not published its 2012 report.*

[6] These guidelines are available at the U.S. Coast Guard's publicly accessible "Homeport" website at: https://homeport.uscg.mil/ (keyword: "Air Emissions").