



## FINANCING THE ROAD TO NET ZERO: MARITIME

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**Host:** Mhairi Main Garcia

Hello and welcome to Watson Farley & Williams' 'Countdown to COP: Financing and Fuelling the Future' podcast series, I'm your host Mhairi Main Garcia.

Today's chapter is all about the maritime sector and a drive towards net zero. I'm delighted to introduce our guest, Lizzie Roe.

Lizzie is a Partner in the firm's Assets and Structured Finance group based in Singapore and a leading maritime finance lawyer in Asia.

She's a member of the firm's Sustainable Shipping Group and was part of the team that produced the Sustainability Imperative – Part 2, a thought leadership report released in March 2023, a follow-up to Watson Farley & Williams' original market leading report released in 2021 looking at ESG in the maritime sector.

Welcome Lizzie and thank you for joining us today.

**Guest:** Lizzie Roe

Thanks Mhairi, I'm delighted to be here.

**Host:** Mhairi Main Garcia

Thank you. Shall we kick off our discussion with where the maritime sector is in the drive towards net zero? Where does the sector stand and what efforts are being made and where is the focus?

**Guest:** Lizzie Roe

So, it is absolutely a key objective within the industry at the moment. There is a broad recognition of the fact that shipping has a very important role to play in meeting global decarbonisation targets. If you look at the maritime press at the moment and even some of the mainstream media, there's a particular focus on alternative fuel sources and that does seem to be something that the industry is really embracing and there is absolutely the will and the desire across the industry to try and achieve this net zero goal. But what's really interesting is if you take a bit of a step back and you look at it in practical terms, where is the industry in reality? And this is something we actually looked at in the Sustainability Imperative that you mentioned just before and that was based on a survey which was done at the end of last year of around 500 people across the industry. And, actually, the respondents in our survey are estimating that, in their view, about 28% of the maritime industry will be meeting the milestones for emission reduction within the next five years.

So, it definitely shows that progress is being made but also, I think it's quite reflective of just the realisation of the magnitude of the task of actually trying to successfully decarbonise the shipping industry.

**Host:** Mhairi Main Garcia

Thanks Lizzie. It's always great to take away some stats from our discussions. And so, based on the Sustainability Imperative respondents – that 28% – that means that there's still a whopping 72% of the industry behind target. What are the biggest challenges to the sector achieving net zero if that's the case?

**Guest:** Lizzie Roe

I think at this stage the biggest concern is definitely uncertainty and that really falls into two brackets. On one hand we've got technological uncertainty and then on the other hand there's regulatory uncertainty.

If we look at the technological issues first, as you can imagine, the new technologies are going to require significant time, significant investment, and it's really difficult to know what the most efficient technology in the future will be. And so, for the shipping industry, there's this real fear of having stranded assets because if you imagine you are ordering new vessels and you're expecting a life cycle of over 30 years but, actually, you've picked the wrong technology and then, in five to ten years, suddenly your vessel is obsolete. And when they're making these investment decisions, there are so many different issues to be considered.

If we take for example alternative fuels you are not only thinking about the actual cost of the investment to get your vessel ready for that alternative fuel, you've got to think about the availability and the cost of the fuel in future; you've got to take into account operational issues, safety issues and also looking at the actual infrastructure, so the bunkering options for the alternative fuels. So, it's a really multi-layered decision that's very difficult to make at this point in time. And, largely as a result of that what we're finding is there's ongoing debate as to whether or not it's more beneficial to retrofit your existing vessels with new technology, and sometimes this can be seen as a sort of short-term win because generally it's less expensive and it can be implemented more quickly.

And, so, what we're finding in reality is a number of the owners and operators we speak to are effectively just hedging their bets and so they're opting for a combination strategy of both retrofit and new vessels. And then if we look at the regulatory issues, owners and operators need to also consider compliance with future regulations targeting decarbonisation. If you think of a vessel calling at various different ports, it's likely to be caught by different rules in jurisdictions and so it's very important for those owners and operators to make sure that they can be in compliance with the different regulations even though there's obviously a risk that some of those may be incompatible with each other. Now, thankfully, the IMO does seem to be taking more of a leadership role on this point and that hasn't always been the case in the past.

Back in July of this year, the IMO unanimously adopted the 2023 IMO Strategy on Reduction of Greenhouse Gas Emissions from Ships (“2023 IMO GHG Strategy”). And, without going into too much detail on this, it's effectively targeting net zero greenhouse gas emissions by 2050 and the idea is there'll be various milestone targets in the interim period to help try and achieve that ultimate 2050 goal. This development has been warmly welcomed by the industry and it's exactly the kind of leadership that the shipping sector needs.

I think there's a broad consensus that it is absolutely critical to have global standards and regulations for the maritime sector.

**Host:** Mhairi Main Garcia

Thank you, it definitely sounds like there are a lot of challenges and, on the technology front, it seems that the debate around retrofitting and new vessels is set to continue.

On regulation, as you mentioned, there's certainly a lot to be done and I think the key challenge, from what you've said, is how to achieve that on a global scale. Has there been much progress over the past 12 months on issues around regulatory uncertainty?

**Guest:** Lizzie Roe

So, in terms of shipping, one of the key developments that we've seen actually occurred earlier this year and the EU voted to include the maritime sector in the EU's emission trading scheme. And this, in essence, is establishing a system for greenhouse gas emission allowance trading within the EU. And the plan is this should come into effect from 1st of January next year. It's worth mentioning that actually based on the analysis we did in the Sustainability Imperative something like 90% of the respondents said that carbon trading carbon offsets were important if not critical for emissions reductions.

But as you can imagine, as with any regulatory development, there are some criticisms. The first is the fact that the EU ETS scheme was initially designed for on-land industrial facilities between owner operator group companies. Now the difficulty is this doesn't work in the same way in shipping. You're dealing with unrelated owners and operators and the big question becomes who should actually pay in these circumstances? Is it your owner, is it your operator, is it your end user?

The other criticism that we heard from some of the industry participants is the fact that this is an EU development and it wasn't implemented globally by the IMO. Now, hopefully that's going to change because the IMO have confirmed as part of the 2023 strategy on reduction on greenhouse gas emissions, they do envisage implementing measures to have a greenhouse gas emissions pricing mechanism. And the EU actually has the discretion to raise the scope of emissions covered from journeys starting outside the EU, above the current 50% threshold if the IMO doesn't introduce their global carbon levy by 2028. I think in some ways the fact that the EU did take the lead is sort of forcing the IMO to catch up and therefore forcing them to actually progress this issue.

**Host:** Mhairi Main Garcia

Indeed, and I think obviously the need for measures at a global level is really quite obvious, particularly in the maritime sector. You mentioned that alternative fuel sources are a particular area of focus within the sector, is there a consensus on the best green fuel?

**Guest:** Lizzie Roe

Currently there is no real agreement on the best alternative fuel and what we're actually seeing is a lot of the shipping companies that we speak to are considering a number of different options. Now, what we initially saw was that LNG appeared to be very popular and was initially considered to be the number one choice as an alternative fuel. But based on the responses in our most recent Sustainability Imperative this actually doesn't appear to be the case anymore.

Now, there's a few possibilities about why that is. I think there's a strong argument that LNG has been quite widely adopted and so it's now considered to be a mainstream transition fuel, so it's not actually viewed as alternative.

What we did see from the Sustainability Imperative is that biofuels were listed as the most popular alternative fuel source. There are concerns about actual availability on a long-term basis and, in particular, is there actually going to be enough biowaste to sustain biofuels for shipping especially when you consider that against the potential competition there is for this as a fuel source from other industries? I think that's quite reflective of the fact that having the desire to make progress and having political and financial will, there's still going to be logistical obstacles which need to be faced in order to make real progress.

**Host:** Mhairi Main Garcia

Thanks, Lizzie. And staying on the topic of fuel and alternative fuels in particular. What stage are other new technologies for alternative fuels at? Is there any noticeable progress on new technologies for alternative fuels?

**Guest:** Lizzie Roe

There have been some very positive developments on the alternative fuel side. We're seeing that methanol appears to be an increasingly popular choice. The Maritime Port Authority here in Singapore was recently involved in the first ship to container ship methanol bunkering operation and it's also indicated that that anticipates it should be ready for ammonia bunkering in 2026. And this is just one of a number of ports that are conducting pilots of this nature.

Now, like I said, there's a number of different fuels under consideration and I don't want to go through all of them, but the other fuel that probably is worth mentioning is nuclear. And we are starting to see a sort of section of the industry that are beginning to argue that really nuclear is the most viable long-term solution. It's still considered to be fairly contentious but there is a sort of growing school of thought that this is potentially a long-term solution whereas the other alternative fuels are maybe more transition fuels.

One final point to mention is that a number of the vessels we are currently seeing being financed are actually dual fuel vessels and so they do have the ability to use alternative fuels, but that doesn't automatically mean that they won't be using traditional fuels, particularly in the short term.

**Host:** Mhairi Main Garcia

So, you would say although progress is being made, it sounds like there is indeed a transition and there's quite a journey still to go in relation to alternative fuels.

**Guest:** Lizzie Roe

Yes, absolutely.

**Host:** Mhairi Main Garcia

Okay, so let's change tack slightly and talk about financing, is funding a concern in the sector?

**Guest:** Lizzie Roe

I think to an extent there is some general acceptance that investment is going to be required to meet emissions reductions targets and, so there will be an additional cost. Although it then does come down to who exactly across the industry should be the stakeholders actually bearing that cost.

The cost currently is expected to be around US\$1-1.5 trillion in order to decarbonise shipping by 2050. So, there is still a huge financing gap and so we cannot completely ignore the issues around funding and investments and, this is particularly a concern for the smaller ship owners, who are not going to have the same resources or access to financing as some of the larger players within the industry.

**Host:** Mhairi Main Garcia

Thank you, Lizzie. Let's take a step back to one of the outcomes of previous COP meetings – the agreement in respect of green corridors. Has this influenced the maritime industry's net zero targets?

**Guest:** Lizzie Roe

Yes, so the Clydebank Declaration was launched at COP26 two years ago and there have been a number of initiatives in respect of green corridor activity following this announcement and actually the level of activity has generally exceeded the expectations. The main issue with the current status of these green corridors though is that they're still under development.

So, in order for a green corridor to progress, it needs to complete a feasibility study and those studies are looking at issues surrounding things like the fuel chain for alternative fuels, port and bunkering infrastructure and investment requirements. But taking a step back, I think there's a lot of positivity to be taken from the green corridor initiative and particularly the level of support for green corridors from key stakeholders, in particular governments, because it's going to be absolutely critical if the industry as a whole wants to achieve net zero, then all of the stakeholders across the industry are going to have to collaborate and work together.

**Host:** Mhairi Main Garcia

So again, it seems that the green corridors are promising, but timing is indeed a challenge.

Let's look at the sector as a whole and where you think it's going to be in the next few years. What will be the most important steps in the next five years to help the maritime sector in the drive towards net zero?

**Guest:** Lizzie Roe

I think there's probably a couple of things. The first thing is very much going to be lessons learned from those first movers in the industry who are already developing new technologies, who are trying alternative fuels and hopefully once that information is shared more broadly across the industry the technology can continue to develop, continue to improve and can be shared widely across the sector.

It's also going to be very important to make sure there's sufficient funding, whether that's coming from governments, coming from banks or alternative investors or, most likely, a combination of all of those. And then above all, it's going to be absolutely critical to make sure we have clearer regulation around decarbonisation going forward. This should be led by the IMO and it's so important that it's applied consistently by governments across the globe and that this is done within the next few years in order to try and reduce that regulatory uncertainty we talked about earlier.

**Host:** Mhairi Main Garcia

Thank you. Lizzie for a very informative discussion. If I can sum up some of the key points, in just a couple of minutes.

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There are two key barriers to achieving net zero in the maritime sector. Firstly, technological uncertainty with concerns around stranded assets and, secondly, regulatory uncertainty with a lack of global measures. The focus to date is very much focussed or centred around fuels with the development of dual fuel technology and alternative fuel sources, but critically it's estimated that only around 30% of the maritime industry will meet emissions milestones in the next five years. So, a lot needs to be done. But as you've said, there is a real will in the sector to make progress and progress is indeed being made.

Lizzie, many thanks for being our guest today and thank you for listening.

We look forward to welcoming you to our next episode of Watson Farley & Williams' 'Countdown to COP: Financing and Fuelling the Future' podcast series.

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