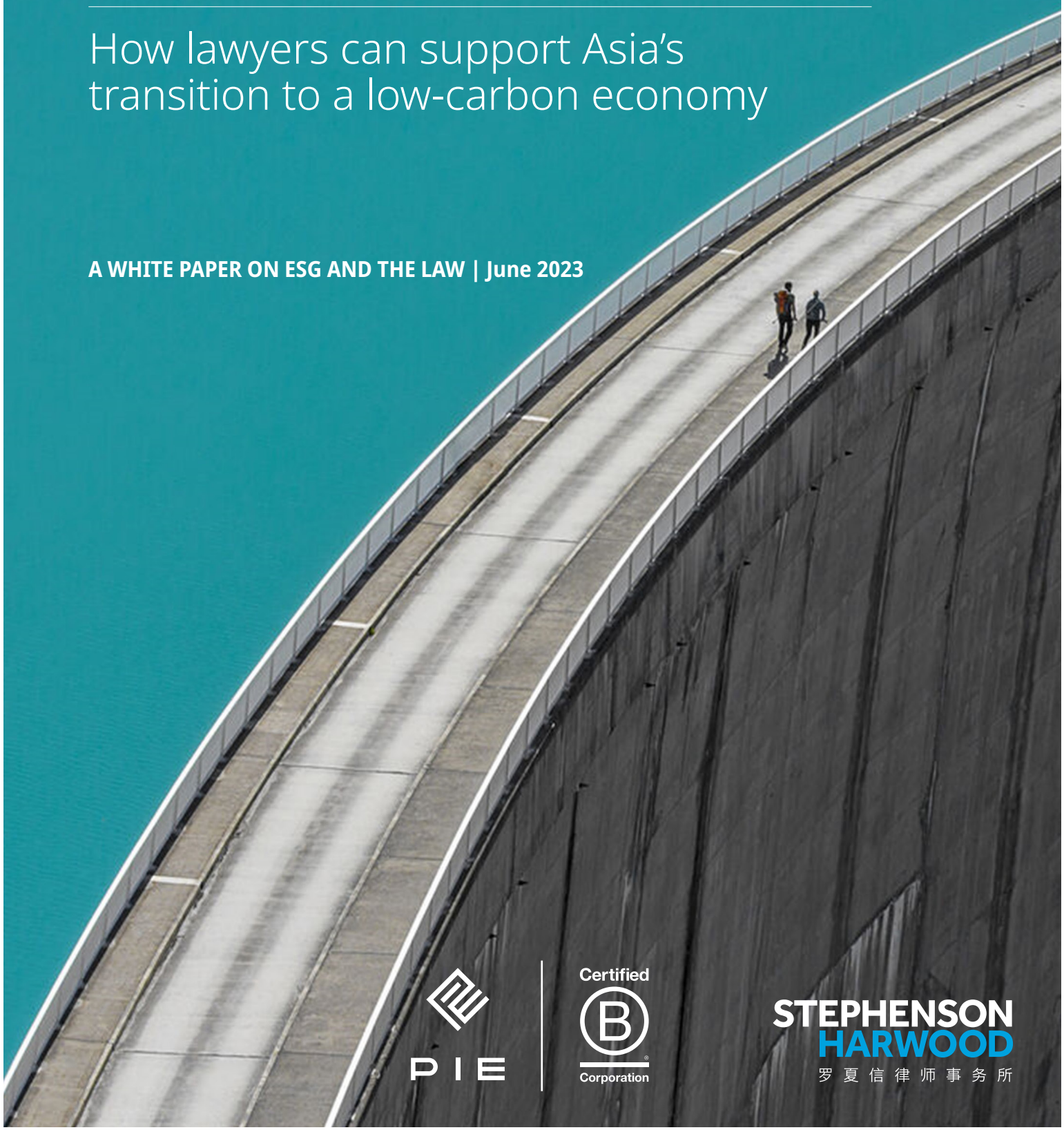
From Uncertainties To Opportunities

How lawyers can support Asia's transition to a low-carbon economy

A WHITE PAPER ON ESG AND THE LAW | June 2023



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Content

Foreword

Building a case for climate action

The terms ESG (a shorthand for "Environmental, Social and Governance"), sustainability and decarbonisation are everywhere – but how are these terms used, are they used correctly and why is this important? How does the decarbonisation or net zero journey start? This paper tries to answer these questions informed by responses from stakeholders.

Climate change, as evidenced by extreme events such as heatwaves, droughts and floods, left its mark on every continent in 2022, and has already affected billions of people worldwide. Climate risks are expected to be a core focus of global risk perceptions in the coming decade[1] – and for which people are thought to be least prepared.

Countries accounting for 88% of global greenhouse gas emissions have set decarbonisation targets in line with the Paris Agreement[2]. The Asia-Pacific region plays a critical role in this global endeavour, given its population and geographical expanse. Concerted commitment to decelerate climate change is critical in Asia-Pacific as the region is one of the world's most vulnerable to climate change impacts - from devastating floods in Pakistan to heatwaves that ruined crops, dried up rivers threatening hydroelectric power supplies in China. More than 70% of the countries in Asia-Pacific[3] have set net-zero or carbon neutrality targets, including the region's largest economies: China, Japan, India and South Korea.

Commitment to climate action is not a new phenomenon in business practice, having been bracketed under the umbrella term ESG matters for a number of years.

More than 70% of Asia Pacific countries have set net-zero or carbon neutrality targets

Legal risks are lurking in the complex web of disclosure requirements and sustainability standards. The ESG label – applied to all manner of E, S and G principles – is a particularly thorny area, especially if you are an investor or company that wants to take your ESG integration seriously. Companies have used ESG as an umbrella term to demonstrate their commitment to some broadly defined ethical values, either as a marketing effort to improve the social credit of their business, or as a metric by which to hold companies to account. However, there is no consistent understanding of what ESG means to each business or how it interplays with current and future policies, regulations and laws. Overstated claims around ESG, or greenwashing, have already been the subject of enforcement actions in the US and Europe. Businesses must move beyond vague statements about disparate ESG initiatives and take concrete steps to transition to a more sustainable development path. They must also realise that with shifting regulatory, consumer and technology landscapes, ESG and sustainability will increasingly impact the company's bottom line. The shift from simple compliance with existing regulation to fulfilment of real ambitions will be a challenge for many businesses.

1 World Economic Forum (2023). Global Risks Report 2023.

2 The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at the UN Climate Change Conference (COP21) in 2015 and entered into force in 2016. The Agreement sets out a global framework to avoid dangerous climate change by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C. The Paris Agreement also embraces "just transition" as a policy direction, in an effort to make sure no workers get left behind in the transition to a low carbon economy.

3 Count of countries in the Asia-Pacific region is based on the number of Asia-Pacific Member States of the United Nations.

With regulators and stakeholders demanding more disclosures on ESG and action on sustainability, businesses and investors in Asia are facing new challenges. In particular, the rising tide of global regulation is forcing international corporations to rethink their entire business process, including understanding and complying with local legislation in the markets where they operate, whilst still meeting international standards in order to remain part of the global value chain. These obligations are increasing.

For example, the Task Force on Climate-related Financial Disclosures (TCFD), introduced in 2017, has since provided a global disclosure framework for companies to report on their governance, strategy, risk management and metrics for managing climate-related financial risks and opportunities. Companies in Asia Pacific are seen to have markedly adopted the TCFD framework and stepped up their reporting of how climate change impacts their business. The recommendations of the newly established International Sustainability Standards Board (ISSB)[4] are also a significant milestone in the market, as they will provide a global baseline for how companies should disclose sustainability and climate-related information and the impact on their operations.

Evolving ESG and climate disclosure standards: More paperwork or a map to clarity?

Major stock exchanges in Asia, including Hong Kong, Japan and Singapore, have already announced their intention to adopt the ISSB standards for listed issuers. These include disclosures related to physical climate risks posed by extreme weather events or chronic change in weather patterns, as well as transition risks and opportunities brought by climate-related regulatory, technology and market environment. They do not as yet include disclosure of how businesses plan to contribute to the Paris Agreement's goal of maintaining global temperatures within 1.5 degrees centigrade above pre-industrial levels. However, proposed legislation in the European Union – which will likely have an effect on any company doing business within and with the EU – will seek to do so[5].

Across Asia, policymakers have made it clear that decarbonisation and sustainability will be central to the future of the region's economy. Supra-national bodies and governments at both national and local levels are seen to be enacting policies intended to direct industry activities and capital flows towards the transition to a low-carbon economy.

Whilst there are risks to this transition, there are also opportunities. Global renewable energy alone surged past US$1 trillion in 2022[6] , and impact investing as a category of investment accounts for another US$1 trillion[7] . With such growing momentum for making profit whilst providing solutions to social and environmental problems, are businesses, investors and financiers taking adequate actions to mitigate the risks and harness the opportunities in the transition to a low-carbon economy?

From understanding the myriad of regulations and how they apply, to helping clients strengthen their ESG-aligned governance structure, to negotiating deals where both risks and incentives of sustainability considerations are integrated, lawyers have a critical role to play.

Everyone goes after the companies or the bonds that will give you financial gain. To overlay this lens [of ESG], it would generally limit the options

- Asset Manager

4 Established in November 2019, the International Sustainability Standards Board (ISSB) is an independent, private-sector body that develops and approves IFRS Sustainability Disclosure Standards (IFRS SDS). The ISSB operates under the oversight of the IFRS Foundation.

5 The Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Parliament on 1 June 2023. Amongst other things, it requires relevant entities to produce transition to low carbon plans to align their business models and corporate strategies with the Paris Agreement goal of limiting global warming to 1.5 degrees centigrade above pre-industrial levels.

6 Global Low-Carbon Energy Technology Investment Surges Past $1 Trillion for the First Time | BloombergNEF (bnef.com)

7 GIINsight: Sizing the Impact Investing Market 2022 | The GIIN

Legal note

Accurate understanding of definitions and words in contracts and regulations is frequently where lawyers bring value to their clients. Finely balancing the literal meaning of a particular word in a contract or the contextual meaning and the spirit of an agreement. Understanding the potential meanings of terms or words as they are used in regulations, judgments, policies, marketing statements and financial documents will assist businesses in understanding their risk exposures and how best to ensure that their commitments to climate transition are being met.

Carbon neutral is commonly used interchangeably with net-zero, however, there are differences as to what the two terms mean exactly. In accordance with the definitions by the Science-based Targets Initiative:

Net-Zero

- A target which requires company to prioritise deep cuts of emissions across its operation and value chain to close to zero emissions, and use permanent carbon removal and storage to counterbalance the residue emissions;
- Emissions reduction is an overarching priority and typically involves reduction of at least 90% by 2050.
- It is important to specify either net-zero carbon emissions or net-zero greenhouse gas emissions (GHGs), which also includes non-CO_2 GHGs, when net-zero claims are made.

Carbon Neutral

- A concept which only requires company offsetting an equal amount of emissions to that it produces through financed emissions removal;
- Emissions reduction is encouraged, but not mandatory and not necessarily in line with what the science requires for the world or at sector level to keep global warming to 1.5°C.
- Carbon neutrality claims do not necessarily cover non-CO_2 GHGs.

Use of an inappropriate term can expose businesses to legal risks of non-compliance with regulations or greenwashing claims.

In this paper, where *decarbonisation* and *carbon* are used, it is intended to cover not just reduction in CO_2 emissions but reduction of all GHGs.

About this report

To explore how the legal services sector can support Asian investors and businesses in navigating this transition and bridge the gaps, Stephenson Harwood engaged PIE Strategy to lead an independent study. Under Chatham House rules[8] , PIE interviewed 26 key decision-makers, ranging from asset managers, financiers and impact investors to business executives and in-house general counsel, to identify their needs, understand the challenges and opportunities they face.

Through a series of in-depth interviews, we gauged sentiment towards ESG, unearthing the opportunities and challenges arising from the transition to a low-carbon economy for investors and businesses based in Asia, particularly in Greater China, and how the legal services sector can support the transition.

8 When a meeting, or part thereof, is held under the Chatham House rules, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.

The interviewees were evenly distributed between the financial and business sectors, and the focus of the engagement of business representatives was in the maritime business ecosystem, along with energy and other business sectors. This approach enabled us to delve deeper into the dynamics for driving systemic change in a specific industry sector, with a view to identifying pointers to turn uncertainties, gaps and barriers into opportunities to thrive in the transition to a low-carbon economy.

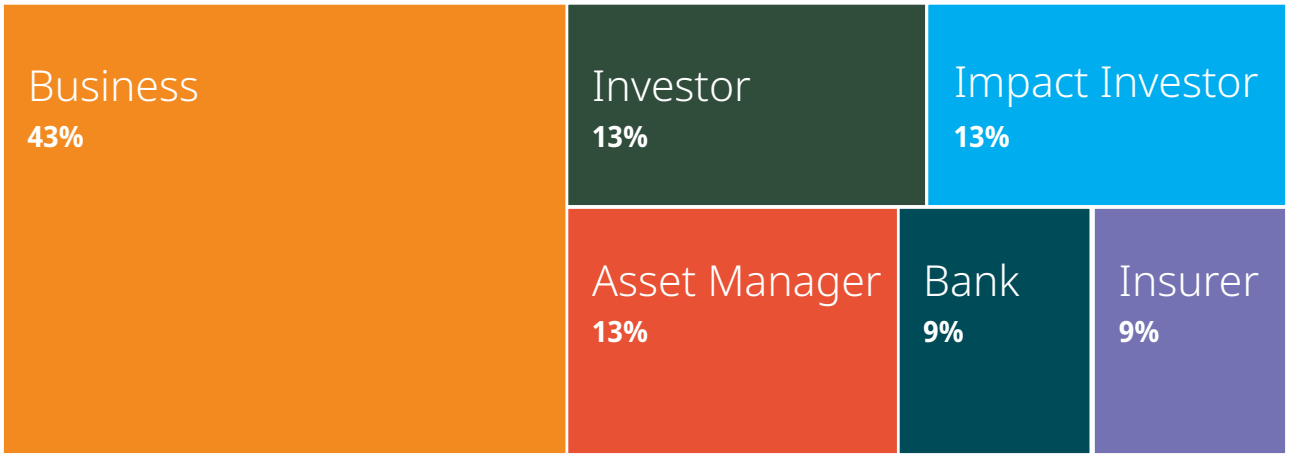
We are shifting to a new economy model. I don't think you can run away from it anymore

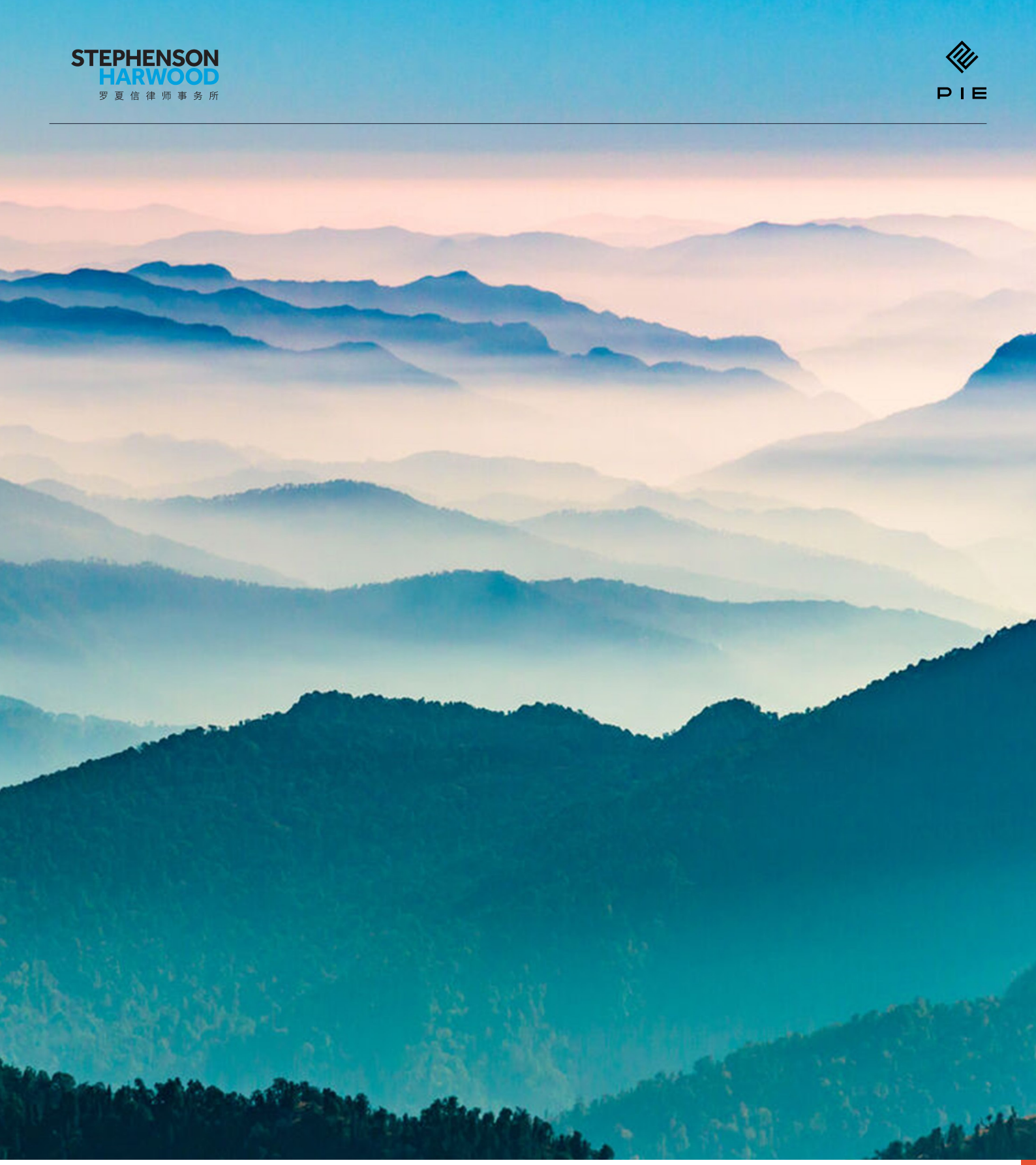
- Financier

I wouldn't say it's a marketing gimmick. But how does that translate into improving a company's returns like the bottom line?

- Asset Manager

Breakdown of Interviewees





Executive Summary

This paper presents a snapshot of prevailing perspectives and challenges to sustainable development in the Asian market. The insights from the in-depth interviews with key decision-makers in the finance and business sectors shed light on the complexities, opportunities and potential strategies for steering towards a low-carbon economy.

ESG AND DECARBONISATION: RELEVANT TO INVESTMENT DECISIONS?

Low-carbon transition is inevitable

No interviewee disagreed with the values and the need for sustainable development. Most believe that the world is at the beginning of an economic transformation. The key question is 'how': **How** to undertake the transition to a low-carbon economy, **how** fast to go, **how** much to invest, and **how** to do it profitably.

Investment is about returns

Every investor seeks returns, including those targeting sustainable and impactful outcomes. Conversations with the interviewees revealed a perceived divide in investment assumptions, perspectives and knowledge in terms of climate- or ESG-related considerations among investors. This divide seemingly exists between groups typically classified as traditional investors and those who are more perceptibly concerned with assimilating impact influences into their investments. However, insights from this research suggest that, rather than a genuine disparity, this might be due to a misunderstanding stemming from widespread confusion over the definitions of ESG and sustainability, as well as prevalent stereotypes.

The problem of ESG as shorthand

The term ESG means different things to different people. The interviews highlighted that:

• Specificity is required to facilitate communication and investment decisions. ESG as a broad concept is not helpful for driving actions.

• Confusion about the definitions of "ESG" versus "sustainability" might have short-circuited the transition to integrate ESG in investment decisions.

THE PARADOXES FOR THE DOERS

Poor disclosure quality blocks investment opportunities

Interviewees highlighted a significant gap in the availability and quality of ESG-related information disclosed by listed companies

Insufficient, inconsistent and poor quality of disclosures makes it difficult for investors to assess companies' exposure to ESG risks and opportunities and blocks investment decisions.

Interviewees from the financial sector commented that regulators should bolster their efforts in mandating and supporting issuers to enhance their disclosure of climate- and ESG-related information.

No teeth in current regulations

Interviewees noted that, understandably, transitions often start with carrots to incentivise, but sticks to drive enforcement are also necessary.

Governance and regulations could be used to create a competitive advantage for an industry or a city, rather than being limiting factors, if governments embrace the fundamental principle of sustainable development in policy design and deliberation. In addition, government has a duty to protect and provide future economic prosperity for all and not just the current players.

Interviewees from Hong Kong noted that there are no teeth in current regulations, with no clear and coherent blueprint for transitioning to a low-carbon economy in Hong Kong. As a result, this contributes to the uncertainty and indecision of industries and investors in the region.

CASE STUDY: CHARTING THE COURSE TOWARDS ZERO-CARBON SHIPPING

The way ahead remains uncertain

The transition away from fossil fuels is the most pressing issue for the maritime industry. All interviewees in the sector acknowledged that change is inevitable, yet uncertainty over which alternative fuel will become the "new norm" makes investment decisions, such as capital investment in building new vessels or retrofitting existing ones, extremely challenging. This uncertainty extends to how the financial and insurance industries price the risk.

All interviewees in the shipping sector called out the lack of clarity on the "new norm", along with the availability and accessibility of technology solutions to support decarbonisation, as barriers to their transition. This is especially unsettling for the smaller players in the industry. On the other hand, some view these challenges as an entrepreneurial opportunity.

The interviews also highlighted the varying appetites for technology risks within the investment and financing industry.

Collaboration is key to bringing systemic change that benefits all

Most interviewees underscored the importance of collaboration and information sharing, which are not just nice-to-have, but necessary for navigating the climate transition. Navigating alone is challenging and risky, particularly for small operators in asset-heavy industries like maritime trade.

The innovation, availability and accessibility of new technological solutions are critical to facilitating the transition, and can potentially present profitable investment opportunities. Mainstream investors might find these opportunities lucrative, while impact investors might view them as chances to play a catalytic role in bridging transitional gaps as well.

Furthermore, collaboration is also needed in understanding and valuing the benefits of technology and to accurately price its risks. This necessitates a collective effort among financial professionals, insurance experts and the broader industry. Engaging all relevant stakeholders early in the process is vital.

THE ROLE OF THE LEGAL SERVICES SECTOR

Legal foresight to help prepare for tougher regulations

Interviewees suggested that legal advisors should not merely focus on today's regulatory requirements, but also help their clients anticipate the evolving regulatory environment and understand their implications. This strategic guidance will empower clients with the knowledge they need to move forward on their transition journey.

While there are uncertainties over how climate-related regulations might evolve, it is certain that there will be more and more stringent regulations for greenhouse gas emissions.

The legal services sector can play a crucial role in providing foresight on this evolving regulatory landscape.

Turning gestures of goodwill into binding but fair contracts

Expectations for climate-related disclosure and carbon emissions reduction are set to rise, particularly with respect to Scope 3 emissions, i.e. value chain emissions. Interviewees pointed out the challenge of distributing accountability across business partners within a value chain. Commitments to emissions reduction targets are often gestures of goodwill, lacking real accountability.

This presents the legal services sector with an opportunity to help translate net-zero emission reduction commitments from goodwill efforts into tangible and accountable actions that are fair for both parties. This not only supports the clients in fulfilling their commitments, but also helps mitigate the risk of greenwashing allegations.

ESG and Decarbonisation: Relevant to Investment Decisions?

The short answer to this question is a nuanced

YES

and

NO

depending on the perspectives of different stakeholders.

Since the adoption of the Paris Agreement in 2015, countries pledging net-zero or carbon neutrality commitments now account for more than 90% of the world's GDP and 85% of the global population. These clear policy signals are poised to reshape the rule of the game in the market over time. However, many businesses, asset managers, and financiers in Asia are still feeling their way through how to incorporate decarbonisation and ESG into their financial and investment decisions.

This chapter examines the perspectives of stakeholders within the financial ecosystem, drawing on our in-depth interviews. We explore how these stakeholders view the necessity of climate action, and the financial relevance of ESG and climate change. By exploring the commonalities and disparities in these viewpoints, we aim to provide insights into the current dynamics and potential pointers to ease the tension between financial and sustainability objectives.

What stakeholders agree on

From ideology to practical action: The need to respond to climate change

No interviewee disputed the values of sustainable development or the need to address climate change as a society; but the translation of these into organisational action has not always been clear.

Now, more stakeholders than ever – from regulators and enterprises to banks and investors – have pledged to put their skin in the game, committing to decarbonisation targets. The "nice to do" has evolved into a "must do". The realm of responsibility has expanded, evolving from "someone else's problem" to "everyone's responsibility".

Interviewees overwhelmingly acknowledged that the transition towards a low-carbon economy is inevitable. Most believe that we stand at the dawn of a significant economic shift, a "new industrial revolution" as the United Nations aptly labelled this climate transition. Moreover, the conversation has pivoted from "if" to "how" and the debate from focusing on the destination to navigating the journey, from ideology to action.

A sentiment of anxiety was apparent among the interviewees confronted with this newfound responsibility. This was mainly due to uncertainties over translating ESG principles and values into tangible investment and business decisions amid uncertainty. These uncertainties ranged from evolving regulations to the availability and affordability of technological solutions. Many interviewees commented that while the shared objective is clear, the roadmap to a low-carbon future is less so.

Three to five years ago, I would say it might just be a spin, but not today. Today, I will say the shift is inevitable

- Financier

Technology is not there yet, but I think the intention is. I think the shipping industry does want to evolve and be sustainable

- Shipowner

What stakeholders need to be aligned on

Navigating the tension: Financial relevance of ESG and climate change

I think it's important to think about these ESG issues, but I think we're in the very early stages of even identifying what these issues are, agreeing that they're important in some way

- Asset Manager

All of us in the financial industry should stop using this ESG shorthand, until we figure out what we're talking about and what we mean by it

- Asset Manager

Climate change is a priority impact area that we invest in. While supporting climate transition, our investment has brought good returns

- Impact-concerned investor

ESG and climate change's financial relevance continue to be a recurring source of tension in investment decisions. All investors, including those targeting sustainable and impactful outcomes, seek positive returns. However, conversations with interviewees in the financial sector highlighted a perceived divide in investment assumptions, perspectives and knowledge concerning climate or ESG-related considerations among investors typically classified as traditional and impact investors. However, insights from this research suggest that, rather than a genuine disparity, this might be a misunderstanding stemming from widespread confusion over the definitions of ESG and sustainability, as well as prevalent stereotypes.

Interviewees reaffirmed that the pursuit of financial returns, stability and business growth is crucial to companies and investors. Some questioned whether applying an ESG lens would potentially restrict returns, as this limits investment options. Some posited that family offices or impact-minded investors can afford to be more idealistic, accepting a trade-off with lower returns for the greater good. Sovereign funds were also viewed as more accepting of such trade-offs, as they might be mandated by government to consider ESG factors. In contrast, some interviewees viewed the incorporation of climate considerations in investment decisions as a profitable opportunity and a strategic move for capital preservation.

Reflecting on the interview findings, it becomes clear that this tension may have stemmed from the confusion over the meanings of ESG and sustainability, leading to misaligned assumptions and perspectives that deter investment in low-carbon transition. Additionally, misunderstandings around impact investing or ESG investing might have created mental blocks for some investors.

Clarifying these terms could be a crucial step in bridging the gap and finding the intersection of financial and sustainability objectives.

Financial relevance of ESG and climate change

The interview findings reflect stereotypical perceptions of traditional investors and investors with a more overt interest in impact factors.

Views and stereotypes of traditional investors	Views and stereotypes of investors with a more overt interest in impact factors
Assumptions	
‣ ESG investment is about trade-offs, add-ons, and compromising returns for the greater good ‣ Impact investing is akin to philanthropy	‣ Mainstream investment overly emphasises short-term gains, potentially compromising broader societal benefits ‣ Impact investing can generate returns on investment. It's not philanthropy
Perspectives	
ESG investment is about: ‣ doing good for the world ‣ managing brand reputation and meeting regulatory obligations (if any) ‣ adopting an idealistic perspective on investment	ESG investment is about: ‣ generating "good" profit from investment ‣ going beyond brand reputation and regulatory obligations ‣ taking a pragmatic world view on investment in the context of the global shifts in policy and market environments ‣ Some adopting a "long tail" investment philosophy, by looking at recurring returns over a longer period
Knowledge	
‣ What is ESG? Why does it matter for investment decisions? ‣ What is ESG for different industries? Which ESG aspects matter to different industries for investment decisions?	‣ In-depth understanding of climate and other ESG issues ‣ In-depth knowledge of specific companies (unlisted and those on secondary markets) gathered through direct engagement

Climate change is an important thematic area that we invest in. We don't label ourselves as an ESG investor, to avoid the stigma and misunderstanding. We beat the index. This is how we get more clients. Our AUM has grown many times

- Impact-concerned Investor

If you made a lot of money and it happened to be ESG, you would go out and tell people you are ESG focused, but it's actually the reverse

- Asset Manager

I don't believe in patient capital. Most of our investment is long tail... mimicking the risk-return and duration for the returns of a long-tail business strategy.

- Impact-concerned Investor

We do actually believe in these values. But truthfully, I cannot recall there's ever been a single case where ESG factors actually affected an investment decision

- Asset Manager

Impact Investing

Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.[9]

9 *What You Need to Know about Impact Investing.* (n.d.). The GIIN. https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing

Bridging the Gap: The Intersection of Financial and Sustainability Objectives

Insights from the stakeholder interviews pointed towards **four building blocks** for bridging the gap between financial and sustainability objectives. These insights could serve as a starting point to identifying investment opportunities beyond obligations and compromises, enhancing not only the resilience and robustness of a portfolio, but also contributing to a sustainable and inclusive future.

1

Clarifying the perspectives and expectations of ESG versus sustainability

2

Enabling actionable decisions through specificity

3

Avoiding tunnel vision

4

Recognising the implicit ESG mandate

Sustainability & Sustainable Development

Sustainability or sustainable development emphasise system sustainability and the feedback loop that influences investment returns. It underscores the interdependence of individuals and businesses within a larger system. It also acknowledges that our investment and financing decisions and behaviours impact societal and environmental sustainability, which, in turn, directly or indirectly affect us through a feedback loop. For example, sustainable finance is about financing both what is already environment-friendly today (green finance) and what is transitioning to environment-friendly performance levels over time (transition finance). Sustainable finance aims to finance private investments to reduce today's high greenhouse gas emissions or other environmental impacts, and transition to a climate-neutral and sustainable economy[10]. It also aims to finance private investments that lead to social progress and other positive impacts on society's sustainable development. In turn, financiers could benefit from operating in a market environment with healthy economic growth and financial stability.

Sustainable Development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

"Our Common Future", 1987.
The World Commission on Environment & Development

10 Overview of sustainable finance. (n.d.). Finance. https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en#what-is-transition-finance

Environmental, Social & Governance (ESG)

ESG considerations are about how external factors present risks and opportunities to a company or a portfolio. ESG investing refers to an investment approach that integrates material environmental, social and governance factors into investment and financing decisions, aiming to generate sustainable financial returns. It is primarily a management approach to risks and opportunities, protecting and enhancing portfolio and enterprise value. System sustainability may be a by-product, but not the primary goal.

ESG is an investment approach that seeks to incorporate greater and more consistent information regarding material environmental, social, and governance developments, risks and opportunities, into asset allocation and risk management decisions, so as to generate sustainable, long-term financial returns.

Organisation for Economic Co-operation and Development (OECD)

1

Unravelling ESG vs. Sustainability: A Difference in Perspective

The terms ESG and sustainability are often used interchangeably, leading to misconceptions about their implications. The nuances between these concepts lie in their different perspectives, which lead to differing expectations.

With clarity of the concept of ESG, it becomes evident that contrary to the assumptions of some investors, ESG investment is not about lowering returns for the greater good. Its aim is to secure sustainable long-term returns. Essentially, ESG investment, particularly relating to climate change, focuses on enhancing the resilience and robustness of a portfolio by limiting risk exposures and harnessing opportunities arising from the transition to a low-carbon economy. This involves anticipating the probable physical impacts of climate change and significant policy shifts shaping the marketplace. For some impact investors, their activities may extend beyond ESG considerations to catalysing system sustainability.

Clarifying these definitions and expectations would be a critical first step for the investment community to integrate ESG considerations into their decision-making process.

ESG	Sustainability
• **How the world impacts me** • **Outside-in** impacts and risks • Goal of **creating enterprise or portfolio value**, regardless of impact on the wider system	• **How I impact the world** (which, in turn, tells me how the world impacts me in a feedback loop) • **inside-out** impacts and risks • Goal of **creating system value**, upon which ongoing enterprise or portfolio value depend

Source:
SDG Impact Standards for Enterprises/PE Funds/Bond Issuers Training Course for Trainer Accreditation by UNDP SDG Impact and Social Value International.

2

Specificity is key to enabling actionable investment decisions

Understanding the differing perspectives and expectations of ESG and sustainability is just the initial step. In our stakeholder interviews, the message was clear: A broad stroke concept is not sufficient to enable actionable investment decisions.

ESG encapsulates many topical components, from climate change, waste management and water stress, to labour practices, health and safety, and diversity. The financial materiality of these issues varies by industry, business activity, market context and stakeholder expectations.

Simply put, different companies present unique ESG risk profiles and growth opportunities. To transform ESG from a broad-based concept into a practical tool to inform investment decisions, specificity is key.

I say ESG, and you say ESG. We think we know what the other person means. But we don't

- Investor

Everyone in the industry is talking about ESG. But, to be honest, I'm not sure I understand what it means fully. And I'm not sure others who talk about the term really know what it means

- Asset Manager

3

Avoiding tunnel vision

ESG investing is not about focusing solely on ESG factors or ignoring them entirely.

For example, it is about understanding the physical risks, and transition risks and opportunities related to climate change. This understanding allows for evaluating and quantifying the financial implications these factors may have on a company or investment portfolio. Incorporating this financial evaluation into an investment model, alongside other influential elements, represents the path forward.

4

The Implicit ESG Mandate

ESG related risk and opportunity assessments are arguably implicit in every investment portfolio. The debate is not about whether a portfolio has specific ESG mandates. Rather, it is about understanding that evaluating ESG-related risks and opportunities is an inherent part of the financial risks and opportunities assessment of any sound investment strategy.

Legal note

On the opportunity side, lawyers can play a key role in designing innovative structures from social impact bonds to blended finance. Impact minded lawyers can also help make due diligence and draft investment agreements or shareholders agreements with **impact considerations** integrated.

For example, Stephenson Harwood advised on the set up of a blended finance private credit impact investment fund (investing in women-led businesses) on considerations such as the domicile, weighing between Hong Kong and Europe, structure and potential tax implications. The fund ultimately chose to be domiciled in Europe, partly because as a private credit investment fund, the fund will not be able to leverage on the Hong Kong private funds profits tax exemption regime, whereas in the relevant European jurisdiction exemptions are available to impact related funds. This is a point that the Hong Kong regulators will need to address to promote the city to become a sustainable finance hub.

The Paradoxes for the Doers

Policy and Regulation

Craving clarity: Unmasking the policy path to aid market transition

Stakeholders noted that there are no teeth in current regulations nor a clear transition plan in places such as Hong Kong.

Typically, "carrots" are used in the initial phase of a transition to incentivise the early adoption of sustainable practices, especially when the necessary means and solutions are not yet widely agreed upon, available or accessible. Some interviewees commented that, at an opportune time, the introduction of "sticks" to drive enforcement is essential to accelerate the transition and ensure market fairness.

Interviewees highlighted a notable concern: Current regulations in Hong Kong lack the necessary force to drive change. The absence of a clear and compelling blueprint for transitioning to a low-carbon economy contributes to market uncertainty and the indecision of industries and investors, hampering the momentum to transition towards a low-carbon future. To address this, the visibility of a timeline indicating when policy incentives would give way to regulations or penalties for non-compliance could encourage more proactive responses. Recognising change as inevitable makes early action to take advantage of incentives more attractive. Ultimately, a balanced mix of incentives and enforcement mechanisms can support effective participation in the low-carbon transition.

What's the penalty for not making the disclosure? When was the last time the [Hong Kong Stock] Exchange or SFC took any kind of serious action against a company for not complying with its ESG rules? There is nothing. It's weak

- Asset Manager

I would say right now it's more a carrot, sort of a small carrot, rather than a stick approach, because it is not as if there is technology out there right now. You can't exactly penalise someone for not doing something when solutions are not available yet

- Financier

Shifting perspectives: Leveraging governance and regulations as catalysts

Regulations and governance may sometimes be perceived as burdens on cost and time, and as impediments to progress. However, some interviewees suggested adopting a more visionary perspective, viewing them as strategic tools that can help cultivate a competitive edge for industries or cities on the path to sustainability.

Interviewees pointed out that governments and regulators have a duty to protect and promote economic prosperity for all in the longer term. With governments that embrace fundamental principles of sustainable development in policy design and deliberation, while balancing the interests of current incumbents with those of future generations, governance and regulations can be potential levers for growth and sustainability.

I look at financial regulations. I look at ESG regulations. I look at these rules as a competitive advantage rather than a hurdle. If you know how to move within those rules and position yourself as a master in ESG principles, you can really outrun your competitors, particularly in times of the increasing importance of ESG-related governance

- Investor

THE PATH FORWARD

We discussed in the previous chapter that the primary aim of ESG is to protect and enhance enterprise or portfolio value, with system sustainability as a secondary outcome. Interviews with decision-makers highlighted the following needs for catalysing the transition towards a low-carbon business ecosystem:

1. Providing a clear and compelling policy blueprint to enable all stakeholders to anticipate how the marketplace might evolve and plan accordingly.
2. Raising awareness within the finance and investment sectors about ESG and its potential impact on future earnings; thereby enhancing the collective capacity to safeguard the stability of the financial system during the transition.
3. Introducing regulations that encourage and normalise actions promoting system sustainability.

Taking China as an example, the nation's decarbonisation policy roadmaps provide businesses with a degree of certainty that enables them to anticipate and navigate market evolution. In 2020, China announced goals to peak carbon emissions before 2030 and achieve carbon neutrality by 2060. These commitments have manifested into more concrete policy directions and goals in China's 14th Five-Year Plan (2021-25), which outlines a strategic shift from "high-speed growth" to "high-quality development". The Five-Year Plan emphasises robust environmental policies and green technology development and sets the goal to reduce emissions intensity per unit of GDP by at least 65% by 2030 from 2005 levels.

These high-level goals are supported by more specific targets detailed in sector-specific plans that follow the main plan. For instance, by 2030, renewable sources are expected to supply 25% of China's energy consumption. By 2025, all new builds must obtain green building certification, and 20% of new car sales are expected to come from electric vehicles. These policies are poised to directly influence the development trajectories of the energy, construction and transportation sectors, and by extension, all other industries within these sectors' value chains.

Though many details are yet to be filled in, this policy roadmap provides stakeholders with the clarity and certainty to plan their contributions towards a shared goal of a sustainable, low-carbon economy.

Reducing emissions is important, but it is not viable to focus blindly on pursuing one thing. China has already announced its carbon neutrality target. Achieving economic goals and other development priorities are, of course, very important. But, China is a country that when it proposes a target, it will really mobilise all forces to achieve it. Otherwise, China would not have made a commitment to the target

- Asset Manager

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Legal note

Hong Kong's Climate Action Plan 2050

In response to the Paris Agreement, the Hong Kong government announced its Climate Action Plan 2030+ in 2017. It followed this up in 2021 with the Climate Action Plan 2050 that further outlined strategies and targets for combating climate change and achieving carbon neutrality. As noted in the 2050 blueprint, Hong Kong invested more than HK$47 billion over the last decade towards carbon reduction measures and in the next 15 to 20 years, it plans to invest another HK$240 billion in similar initiatives. This includes developing distributed renewable energy, managing energy demand such as boosting energy efficiency and conservation in both new and existing buildings, decarbonising the vehicle fleet to reach zero vehicular emissions, and transforming waste management systems to cease landfilling of municipal wastes.

Development into an international centre for green technology and finance

Hong Kong will further promote the green economy for necessary sustainable development, and along with China's plans to meet the "3060 Dual Carbon Targets". To do this, it seeks to build a green technology ecosystem to attract top-notch enterprises or start-ups, and encourage efficient interaction among industry, academia and research sectors to commercialise successful R&D; boost demand for green technology through policy support; enhance green finance innovation to more efficiently and conveniently channel capital towards green projects; develop green certification and alignment with international standards; drive green talent training; and raise the level of green economy exchange and cooperation globally as well as with the Guangdong-Hong Kong-Macao Greater Bay Area. The green economy, as Hong Kong set out in its 2023/24 budget, can drive economic change sustainably to generate growth and the city will go on gathering resources such as technological innovation, finance, commerce and manpower towards this end.

Disclosures
Overcoming the disclosure deficits

In the quest to harness ESG investment opportunities, meaningful and comprehensive disclosure is essential. Currently, there is a significant global shortfall, including in Asia.

Interviewees commented that companies often present their ESG performances without financial context. Insufficient, inconsistent and poor quality disclosures from companies makes it difficult for investors to assess their exposure to ESG risks and opportunities, and blocks investment decisions. Interviewees from the financial sector are looking to regulators to mandate enhanced climate- and ESG-related disclosures from issuers.

A promising development is the forthcoming IFRS Sustainability Disclosure Standards by the ISSB, set for release by the end of June 2023[11]. These standards promise to offer high-quality, globally comparable ESG information for capital markets, informing companies about what and how they need to disclose. A number of stock exchanges, including in Hong Kong, Japan and Singapore, have announced their intention to adopt the ISSB standards as part of the disclosure requirements for their listed issuers.

Hong Kong is a great example of the regulator imposing standards on asset managers higher than really what's required of Hong-Kong-listed companies. There's a mismatch with the new climate risk disclosure rules in Hong Kong. It presupposes a reporting regime in Hong Kong that doesn't exist

- Asset Manager

We may be holding ourselves to a very high standard, but what climate or ESG analysis we provide to our investors is something that's quite crude and incomplete, and probably stale. That's because there's very little transparency from listed companies. After all, I think you can only give what you can. The majority of companies aren't making sufficient meaningful disclosure that is of any use

- Asset Manager

THE PATH FORWARD

The interviewees suggested several courses of action:

1. Regulators should raise the compliance requirements for climate and ESG-related disclosures by issuers, ensuring these are adequate, comparable and of high quality for effective investment decision-making.
2. Regulators could actively engage in ESG capacity building to empower issuers to disclose effectively and meaningfully.
3. Upgraded compliance and disclosure requirements are not just about ticking boxes. They could guide companies to improve their governance of climate and ESG risks and opportunities, unlocking substantial benefits for sustainable growth. Furthermore, companies could leverage technology to streamline the disclosure process, thereby improving efficiency and accuracy, and maximising the benefits of data-informed decisions.

[11] The first two IFRS Sustainability Disclosure Standards will be on General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and Climate-related Disclosures (IFRS S2). They are expected to be issued by the end of Q2 2023.

Technology
Steering through Technology Risks

New technologies and their mass adoption are integral to enabling climate transition. This journey towards a new normal requires a shared understanding among stakeholders to assess the value of technological benefits and appropriately price technology risks. Regulators, insurers, industry operators and entrepreneurs all have differing risk thresholds. Each brings unique perspectives, needs and concerns. Understanding these elements is vital to accelerating technology applications and adoptions.

Insights from our interviews revealed an intriguing paradox. There is a strong interest to fund new technologies, evidenced by banks considering loans for green upgrades and investors readily financing tech start-ups. Yet, there is also well-grounded caution against assuming undue risk in supporting decarbonisation technologies without a proper understanding and pricing of associated technology risks.

I don't think one can tell the regulator to set aside less risk for decarbonisation ... it's very dangerous. I sometimes wonder if we should charge higher interest or lower interest rates for green loans

- Financier

The insurance industry has always brought the biggest growth out of new technologies. And we are now at the tipping point once more ... you cannot transfer a risk that is neither understood nor managed. Insurers, and regulators as well, need to be on the inside, not on the outside, because technology is moving so fast, and the regulators and insurers are getting left behind

- Insurance professional

THE PATH FORWARD

A key takeaway is that the evaluation of technology risks is shifting. For instance, the focus has moved from the risk exposure of specific assets to a client's credit capability – their ability to repay a loan. Notably, there is a growing recognition of the need to collaborate and stay open to new methods of risk assessment and mitigation.

The path towards a sustainable, low-carbon economy is shaped by a complex interplay of distinct, yet interconnected, forces. To create an environment conducive to transforming values and principles into tangible actions, it will require a shared understanding of the value and risks of technology, advocating robust climate- and ESG-related disclosures, and promoting enlightened policy development. This journey may be demanding, but it is through these challenges that businesses and investors will uncover future opportunities for sustainable growth and resilience.

From Uncertainties to Opportunities

Industry Focus on Charting the Course Towards Zero-Carbon Shipping

As one of the world's oldest industries, primarily powered by fossil fuels, shipping significantly impacts global trade and the environment. More than 80% of global trade by volume is transported across the oceans[12] contributing about 3% of the world's total greenhouse gas emissions annually. With maritime trade volumes set to triple by 2050 due to rising global freight demand, the urgency to decouple shipping activities from emission impacts becomes paramount to avert exacerbating climate change.

Fuel Choice: The Industry's Burning Question

Insights from interviews with decision-makers across the shipping industry, from shipowners and charterers to bunker suppliers, port operator and insurers, echo a clear consensus: Change is inevitable, and emissions reduction is imperative. The choice of future fuel is the industry's most pressing issue, and the uncertainty around the 'new norm' complicates investment decisions, such as new vessel construction or retrofitting existing ships. The current favourites are LNG and methanol, due to their relatively more mature technologies and well-developed ecosystems, compared to other contenders such as ammonia, hydrogen or electric. However, this uncertainty further intensifies as the financial and insurance industries grapple with pricing the risks of these new fuels with unfamiliar risk profiles.

Other techniques employed by participants in the maritime sector also include the installation and operation of wind harnessing technologies such as sails, rotor sails and kites. These are seen as a way of reducing the carbon output of a vessel, without resolving the zero-carbon challenge.

I would say that the carbon, greenhouse gas issue is the most relevant at the moment because it's having a huge impact on what kind of ships we buy and sell. From a business perspective, that's the most relevant

- Shipowner

We don't have the technology available to meet the IMO 2030 targets yet. It's a very interesting time for shipping, a very challenging time, a time of a lot of uncertainties

- Shipowner

12 UNCTAD (2022). Review of Maritime Transport. Available at https://unctad.org/publication/review-maritime-transport-2022.

A Collaborative Approach

Stakeholders expressed varying views on the pace of the transition towards the International Maritime Organisation's (IMO) emission reduction targets for 2030 and 2050. In an asset-heavy maritime industry, the cost of transitioning to alternative fuels is considered substantial. Some anticipate a step-by-step approach to navigating the cost and risk, possibly starting with one fuel type for the 2030 target and transitioning to another for the 2050 goal.

There is a clear demand for new technologies to facilitate the transition, and this is highlighted by stakeholders as a critical gap. The journey towards zero-carbon fuel requires a collective push from the whole ecosystem – from shipbuilders to regulators. As the industry prepares for the inevitable change and navigates the technical, safety and economic challenges of new fuels and technologies, the shipping industry finds itself at the start of a transformative, albeit uncertain, voyage.

Technology is not there yet, but I think the intention is. I think the shipping industry does want to evolve and be sustainable. It doesn't just want to keep burning horrible fuel that has huge carbon emissions and equally the shipping of it

- Shipowner

The IMO's Mandate: Setting the Path for Sustainable Shipping

The IMO, an agency of the United Nations governing the international shipping industry, has set targets to reduce average carbon emissions from ships by at least 40% by 2030, compared to in 2008, and aims for a 70% reduction by 2050. To accelerate efforts on climate change mitigation, the IMO has been working on a revised decarbonisation strategy, due for consideration at its Marine Environment Protection Committee (MEPC) session in July 2023.

Under the framework of the Initial IMO Strategy, new mandates have been enforced, requiring ships to improve their energy efficiency and reduce their carbon emissions. Effective from 1 January 2023, all ships must calculate their attained Energy Efficiency Index for Existing Ships (EEXI) and new ships are benchmarked by the Energy Efficiency Design Index (EEDI). Shipping companies are also required to begin data collection for calculating their operational carbon intensity indicator (CII) and reporting their CII rating annually.

Legal note

Although **collaboration** has been raised by stakeholders as a key to reducing the world economy's carbon addition, it presents some practical and legal hurdles.

The maritime economy has been described by Martin Stopford in his book *Maritime Economics* as "the 'perfect' marketplace...an economic Jurassic Park where the dinosaurs or classical economics are free to roam". In other words the economics of the industry are largely unregulated, and from a legal perspective the industry is tied together by a network of contracts with little overall consistency – the common features are: freedom of the high seas, freedom of contract, privity of contract and party autonomy. This presents a real practical barrier to effective cooperation, where contracts are finely balanced to give (perceived or actual) economic advantages to the parties.

The sharing of information can also be illegal under competition or anti-trust laws. High fines running to multiples of global turnover can be imposed by competition authorities in cases where there has been an exchange of information that can be considered to be price sensitive. Cartel behaviour is highly regulated.

Regulations about publication of information about GHG emissions could be considered to be highly economically sensitive. In fact the intent of the current regulation appears to be to let the market self-regulate. For example, where the IMO CII regulations will lead to ships being graded according to their carbon intensity, it is anticipated that ships graded A or B will command a premium and ships graded D or E will be untradable. Proposed clauses dealing with CII require performance related information to be shared up and down vertical relationship chains. While good for the planet, it may be anti-competitive behaviour.

The commercial situation is somewhat complicated in that shipowners are often also charterers, and the performance of ships, or measures adopted for the reduction in carbon intensity (such as routing and energy sources) may give participants competitive advantages and thus affect the price of freight or hire. Some of this could be seen as cartel behaviour and breach of anti-trust or competition law. Skilled lawyers can help assess what and how such information can be exchanged.

Charting Uncertain Waters: The Dynamics of Choosing Future Fuels

The shipping industry is navigating uncharted waters to seek the ideal low- or zero-carbon marine fuel. This choice is crucial, with implications for everything from investment decisions to long-term business planning.

The Fuel Frontier: Investment Trends

According to an industry database[13], LNG led the race, with 222 of the 275 alternative-fuelled ships ordered in 2022 designed to run on it. However, methanol is gaining ground, with 35 ships ordered in the same year. Eighteen hydrogen-fuelled ships were also ordered, from small crew transfer vessels built for full hydrogen operation to large cruise ships using hydrogen fuel cells for a portion of their onboard energy needs.

Methanol fuel systems, which are cheaper and simpler to install than LNG, particularly on smaller vessels, came into their own in 2022. They emerged as a potent alternative to LNG, with engine manufacturers noting a surge in demand for methanol-capable engines.

While a majority of shipping operators continue to invest in LNG-powered vessels, industry new-ship order registries reflect an emerging trend towards methanol-powered ships. This is echoed by our interviewees. Among them, smaller shipowners tend to adopt a cautious approach, holding off substantial capital investment in alternative fuel vessels. On the other hand, interviewees from larger operators have started to invest in LNG and methanol-powered ships, with a noticeable preference towards methanol over the past year.

13 DNV. (n.d.). online database. Alternative Fuels Insight Platform. www.dnvgl.com/afi. Accessed 20 May 2023

I think there's definitely an element where people don't necessarily want to be the first, and spend a lot of money, only to find out it's not the right solution. This is understandable – it's human nature

- Shipowner

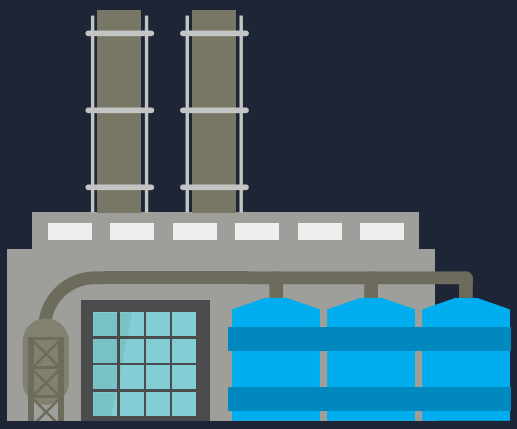
I do see that the larger shipowners are starting to sign memorandums with shipyards to explore building methanol and ammonia vessels. A lot of our clients are also making investments in building dual-fuel LNG vessels, which in our view, is a transition fuel

- Financier

Seven of the world's top-ten shipping companies have announced plans to order methanol-powered or dual-fuel vessels for delivery within the next five years, accounting for over 70 containerships. This includes major Asian companies such as COSCO, Evergreen, HMM and ONE, which collectively have more than 50 methanol-powered containerships on order.

Different Types Of Methanol

Blue Methanol

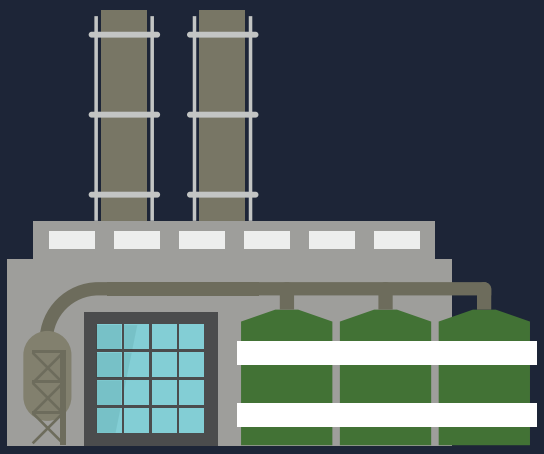


SOURCE

Blue hydrogen in combination with captured CO_2

Production considered to significantly lower well-to-tank CO_2eq emissions.

Green Methanol



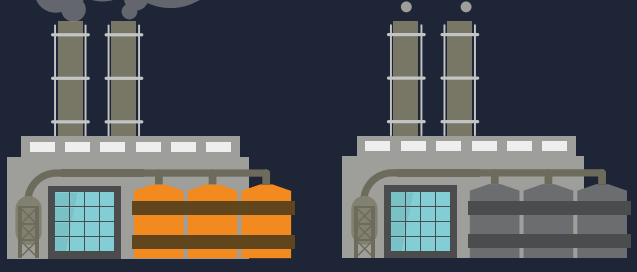
SOURCE

Bio-methanol produced from biomass or e-methanol produced from green hydrogen, captured CO_2 and renewable electricity

Production considered to reach carbon neutrality on well-to-wake basis.

Grey Methanol

Brown Methanol



SOURCE

Coal

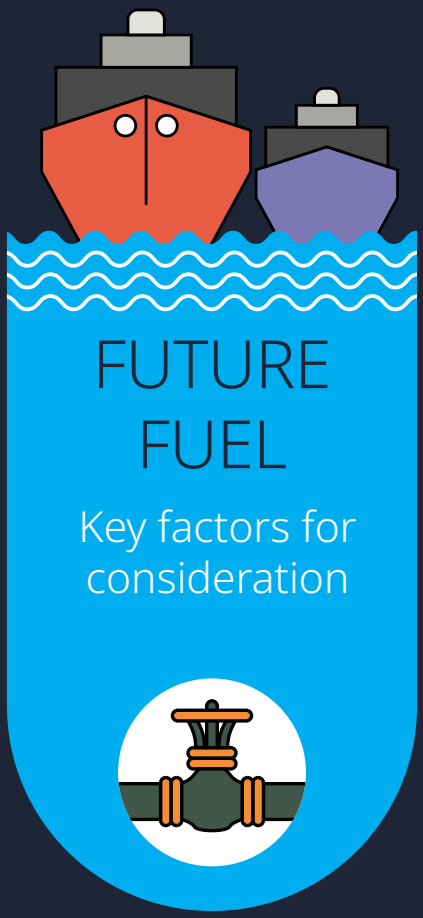
SOURCE

Natural Gas

Production considered to result in high well-to-tank CO_2eq emissions.

Weighing the Options: Considerations in Choosing Future Fuel

Numerous factors come into play when investing in vessels powered by alternative fuels. The following are some of the key factors to consider:



Energy Density[14]

This impacts fuel suitability for specific ship types/operations, affects cargo capacity and determines travel distance before requiring refuelling.

Bunkering Availability

The accessibility of bunkering facilities for the chosen fuel, which can limit vessel destinations.

Capital Cost

Covers expenses for retrofitting existing vessels/engines, new builds and fuel storage.

Energy Cost

Alternative fuels typically cost more than traditional marine fuels. LNG, methanol, and LPG offer more competitive costs, while hydrogen and ammonia are more expensive.

Commercial Readiness

Readiness for commercial application, tested and regulated.

Technology Maturity

Alternative fuel should be technically developed and proven for safe usage.

Well-to-Wake Emissions

Considers emissions from fuel production, transport and storage, to onboard combustion. Alternative fuels should ideally yield significantly lower emissions, potentially nearing zero.

14 Energy density affects a fuel's suitability for different ship types and operations (e.g., shortsea vs. ocean-going). For example, due to their low volumetric and gravimetric densities, batteries are generally impractical for deep-sea operations. Fuels such as LNG, LPG, methanol, ammonia and liquid hydrogen have varying energy densities, typically 40-70% lower than diesel. In contrast, biodiesel closely matches traditional fuels such as heavy fuel oil (HFO) or marine diesel oil (MDO). These differences directly impact a vessel's range before refuelling and its non-fuel cargo capacity.

Legal note

There remain several barriers to switching to alternate fuels:

Technology – technological readiness is still in progress, with some alternatives at a more advanced stage than others.

Contracts for the construction of vessels that will burn new fuels will need to anticipate rectification work in the event that engines do not perform properly. Contracts in relation to retrofitting vessels – if possible – will require appropriate clauses to deal with waste oils. The mapping of responsibilities in case of technology failure will require careful drafting from lawyers anticipating unknown technologies and processes.

Financing – Environmental risk is an important decision-making factor for many financial institutions which has led to initiatives such as the Poseidon Principles, the Climate Bonds Initiative (which rewards vessels not carrying hydrocarbons or on the journey to zero-emission) and the Green Shipping Financing/Guarantee Programme (which supports financing of greener vessels, and retrofitting of existing ships). Financing retrofits presents legal challenges, for example whether the new equipment is covered by the existing security documentation or whether it is possible or appropriate to enter into new security documentation.

Quality – Unknown components in fuel can damage engines causing physical damage, delay and danger to shipping and the marine environment as vessels lose power. An examination of the traditional apportionment of risk and liability may be necessary either with the demand from charterers to use alternative fuels, or the availability of ships with one or other type of new fuel.

Transition – Following the transition from high sulphur fuel oil to low sulphur fuel oil consequent upon the change in IMO regulations in 2020 there were a large number of disputes, not just on quality, but also on cost and availability. Parties to maritime contracts will need to be reconsidered to ensure consistent quality supply of fuel at affordable prices. This has the potential to severely impact the commercial operations of both shipowners and charterers.

Cost – Quite apart from the cost of engineering vessels to burn alternative fuels, the cost of the fuels themselves is currently many times greater than fossil fuel. Questions as to who should pay for these increased costs will need to be resolved by reviewing contractual relationships. It is anticipated that operating expenses for shipowners with alternative fuel ships will increase dramatically. Charterers and cargo interests may not be ready to pay for these increased costs.

Setting Sail towards Net Zero

The vision of achieving zero-carbon shipping will require a balance among innovation, safety, practicality and commercial viability. Insights from our interviews indicate that the near-term choice of alternative fuel may not necessarily be the long-term solution for reaching the 2050 targets.

Some industry leaders foresee multiple transition paths to mitigate risks and cater to varying vessel operations and risk tolerances before settling on the fuel of the future.

The interviewees in this study, supplemented by secondary research, identified the probable medium-term and long-term strategies for different vessel types.

Methanol is the fuel we are researching. A carbon-neutral fuel is not ready yet, but we can start with grey methanol and eventually transition to green methanol. Grey methanol production is quite a mature technology. It has been used in industry for quite some time. The challenge now is to apply it in a ship environment and gradually transition to producing methanol with zero carbon. Even though we are putting our money on methanol for the future and this is the direction that we are currently taking, we are eager to know what other players in Asia think about this direction

- Shipowner

Technical feasibility is certainly one of our main concerns. Another is fuel availability – I mean, our ships sail all around the world. We need a fuel supply that's reliable and available worldwide. For instance, right now, ports supplying LNG are quite limited. It's not like a ship is always sticking to the same route. Say a ship typically sails between China and Australia, and it works fine. What if the ship has to go to Africa next? You might not find an LNG supply there.
So yes, easy and widespread fuel access is a big deal

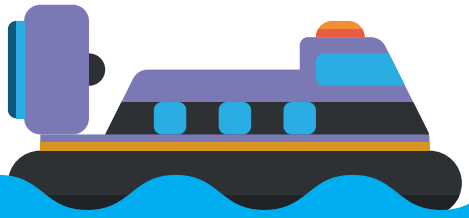
- Shipowner

When we talk about green methanol, it's produced through carbon capture technology, which means it isn't just clean, zero-carbon energy, it can actually go a step further and be carbon-negative. We're talking about capturing carbon and then using a solar-powered electrolysis process to produce the methanol. It's truly ground-breaking. It's one of our future goals and is an important focus in our R&D efforts right now

- Shipowner

2030 Target

Medium-Term Strategies



Short-sea vessels

As power grids continue to evolve, hybrid or fully electric ships and those powered by biofuels are set to become more popular in this segment of the industry.

Ocean-going vessels

A different trajectory is anticipated for ocean-going vessels. Transition towards **LNG** or **methanol** as alternative fuels is expected, particularly for containerships. Methanol stands out as a strong contender due to its ease of handling compared to LNG.

Industry players, including our interviewees, are investing in technology and experimenting with methanol as a fuel source for their fleets. Initially, brown or grey methanol produced from coal or natural gas is anticipated to be adopted, with a future shift towards blue or green methanol, produced with carbon capture technology and renewable energy. The shift is anticipated to be a drop-in replacement, without needing expensive retrofitting when these cleaner options become more available and cost-effective. This does not solve the well-to-tank emissions but is a significant step in the transition.

2050 Goal

Long-Term Strategies

Short-sea vessels

Fully electric systems offer zero emissions when powered by renewable sources, but their low energy densities and high storage costs limit their feasibility to specific vessel types and short sailing distances.

Ocean-going vessels

The strategy for meeting the 2050 targets is still in development. While hydrogen, methanol and ammonia are being considered, they have their own challenges.

- **Hydrogen** has the potential for use in internal combustion engines, gas turbines and fuel cells, yet needs significant technical advances to become a viable, large-scale commercial fuel option. Interviewees believed that the commercial application of hydrogen on ocean-going vessels is still in its infancy, with a range of challenges to overcome, including technology innovation, safety, affordability and accessibility.
- **Ammonia** has the potential to serve as a zero-carbon fuel but has safety and odour concerns. Its toxicity and stringent handling requirements pose challenges, but designs for ammonia engines are in the pipeline.
- **Methanol**, as noted by some interviewees, has been used in industrial processes for energy generation, and as a cooking fuel with a long history in Hong Kong and other cities in China. The challenge is to transition its feedstock from brown and grey to green, potentially aided by carbon capture technology and renewable electricity for its electrolysis process.
- **Other possibilities** include Hydro-treated Vegetable Oil (HVO), a second-generation biofuel, and fuel cells using methanol or ammonia.

A Focus on Sustainability: Every Action Counts

Interviewees in the shipping sector are also proactively exploring and testing a variety of initiatives to reduce fuel consumption. Not only does this lead to savings in fuel cost, but it also helps to curb emissions.

Drawing on the personal experiences of interviewees and their peers, discussions spotlighted initiatives that have proven effective in reducing fuel consumption, lowering costs and mitigating emissions. These practical initiatives are expected to contribute meaningfully towards achieving the 2030 emission reduction targets.

We do quite a bit in general fuel efficiency initiatives. We put bottom paint to make our vessels move faster. We use different propellers that are more efficient so the vessel moves through water using less power. Different technologies that can reduce drag and increase propeller blades or bubbles under the hull … or features of the vessel that would improve its performance like, for instance, sails or wind blades that harness wind power to speed up the vessel. That's probably one thing. And the other is obviously just engine technology, making engines that are more efficient and burn fuel more efficiently and cleanly. These are the key things we look at

- Shipowner

Simple actions, such as **reducing the speed** of containerships by a mere 1 or 2 knots, can have a significant impact, resulting in carbon emission reductions of 6% and 11%, respectively.

Communication between ships and ports can be enhanced by using detailed data on vessel positions and berth availability, leading to more efficient marine traffic. This streamlined approach can potentially reduce around 10-11% of carbon emissions annually.

Optimising ship design and hydrodynamic efficiency through fleet modernisation can enhance energy efficiency. Advanced analytical tools assist in improving hull forms, propeller designs and rudder arrangements. Innovative coatings[15] help mitigate the physical and biological causes of hull surface roughness, thus reducing hydrodynamic friction.

Leveraging meteorologic and oceanographic data to **optimise shipping routes** can potentially save up to 15% in fuel consumption and emissions.

Advanced analytics are facilitating improvements in **vessel utilisation** by minimising ballast time and optimising cargo loads. These can potentially reduce the overall fleet requirement. Even a 10% improvement in the ballast ratio can lower carbon emissions by 3.3-3.7%, depending on the vessel type.

15 ABS: Setting a course to low carbon shipping, pg. 23

Legal note

Perhaps one of the **biggest single carbon inefficiencies in the maritime industry** emanates from contractual obligations between the many layers of owners, charterers, cargo interests and bill of lading holders. The obligation is to perform each voyage with "utmost dispatch" which results in the phenomenon of "sail fast then wait".

Other factors which impact on the adoption of this operational practice are: speed warranties in time charters, laytime and demurrage in voyage charters. None of these take account of the conditions at the port of discharge.

"Sail fast then wait" is incompatible with the imperative of carbon efficiency for the purposes of shipowners' regulatory compliance, as well as with the Scope 3 commitments of users of ships. Beyond the transition, and in the era of zero-carbon fuels, it will be incompatible with energy efficiency, which will be vital due to the much lower energy density of those fuels.

A project that seeks to eradicate "sail fast then wait" is the Blue Visby Solution ("BVS"), which takes a systemic approach and deploys a contractual architecture embracing the entire supply chain. It also includes a sharing mechanism inspired by general average, designed to incentivise adoption, which can be reinforced through the ship finance facility documentation.

Stephenson Harwood has been deeply involved in the development of the BVS, more information can be obtained here: Home - Blue Visby Solution. One of the principal challenges will be the re-thinking of laytime and demurrage calculations. At present shipowners and charterers as well as trading houses, insurers and lawyers spend many hours dealing with differences of opinion in relation to calculating and disputing the additional costs of voyages caused by delays at loading and discharge ports. It is even a profit centre for some companies. In such circumstances it is a challenge to arrive at a solution which rewards parties for acting in a way in which minimises carbon output.

Sailing Together: Common but Differentiated Responsibilities

Both industry leaders and smaller operators have the ability and responsibility to contribute to decarbonisation, echoing the principles of common but differentiated responsibilities. Leaders in the shipping industry are expected to lead the charge, helping the industry define the standards for future fuels, while potentially securing a first-mover advantage. Smaller operators, on the other hand, tend to look to industry leaders for cues on investment directions. Nonetheless, they can contribute to emission reductions, such as by route optimisation, judicious timing of ship arrivals and using innovative coatings to reduce friction while sailing, in the interim.

These expectations are believed to resonate not just within the shipping industry, but also across other sectors, reflecting a collective commitment to a sustainable future.

Unlocking Investment Opportunities

Technological innovation is urgently needed in the shipping industry to facilitate this transition and may also unlock profitable investment opportunities. Mainstream investors might view these developments as opportunities to reap lucrative returns, while impact investors can use them to bridge transitional gaps and catalyse change. Furthermore, establishing a common understanding in assessing the benefits of technology and the associated risks is critical. This requires a collaborative effort involving financial professionals, insurance experts and the broader industry. Early engagement of all relevant parties in the process is important for appreciating the value of technological benefits and appropriately pricing its risks.

Harnessing Collective Strength in Decarbonising Shipping

In the intricate web of the maritime industry, every player has a role in the transition towards a zero-carbon future. Whether a maritime trade industry leader or a small-scale operator, banks or investors, each is a critical part of this dynamic ecosystem. From our interviews, a fundamental theme has emerged: The crucial role of collaboration and information sharing in managing this climate transition.

Stakeholders highlighted the indispensable need for collaboration and open dialogue, particularly for smaller operators in this asset-intensive industry. The journey to zero-carbon shipping is not one to be travelled alone; it is fraught with challenges and risks. Collaborative efforts, far from a mere convenience, are a necessity in charting the course to sustainable shipping.

While one cannot make an asset-heavy maritime industry lighter, one can make it smarter. Making it smarter through the adoption of sensors, the Internet of Things, and additional data sources and analytics to help predict e.g. weather and optimising the routing to reduce fuel use and carbon emissions. Other measures, such as a smart choice of coating for the hull, can help reduce friction in sailing, thereby saving fuel use and reducing emissions

- Investor

Legal note

Despite calls for cooperation it is impossible to deny that the maritime industry is a litigious one. This arises out of the multi-layered contractual nature of the industry and the risks and uncertainties that are inherent in ocean transportation.

Even in trying to achieve appropriate clauses to deal with the IMO's CII regulations consensus has yet to be found.

Every aspect of the maritime industry will be impacted by decarbonisation. This will lead to **contractual disputes** across the entire spectrum. For example:

- Operational disputes arising from regulatory compliance;
- Technical disputes, equipment performance disputes, bunker disputes, shipbuilding warranties;
- Financial disputes, regarding application of standards, KPI compliance;
- Collaboration disputes, including anti-trust, intellectual property, information sharing disputes;
- Voluntary Carbon Market disputes regarding projects, the secondary market, offsets, insets, mass balance, book & claim – especially in the context of the absence of regulation and standardisation of carbon accounting;
- Greenwashing disputes.

It may be possible that the Brussels Convention 1952 on ship arrests could be used strategically to disrupt and draw attention.

Most maritime contracts are subject to arbitration agreements. Arbitrations are by their nature confidential which has advantages - parties can keep the nature of the climate dispute private as between them – and disadvantages there will be no public record of decisions. Therefore, there will be no body of law about certain types of breach or what constitutes good practice. Only the parties and the lawyers involved in such actions will know how arbitrators will consider certain matters.

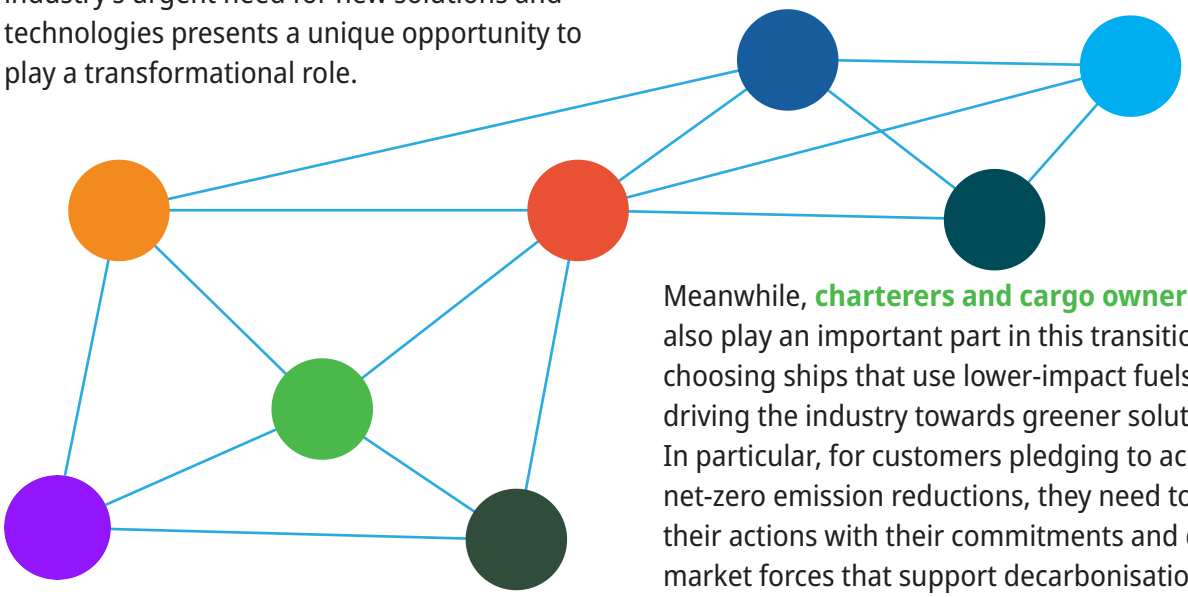
Pioneers and Partners

While leaders and pioneers in the shipping industry are forging their way towards a low-carbon future, other stakeholders in the ecosystem also play significant roles in shaping the industry's future.

Banks can facilitate green transition by offering green financing and sustainability-linked loans, thus incentivising shipping companies to invest in cleaner, more fuel-efficient technologies.

Investors have untapped opportunities to leverage the changing regulatory requirements and industry trends, leading to attractive financial returns and investment avenues.

For **impact-concerned investors**, the maritime industry's urgent need for new solutions and technologies presents a unique opportunity to play a transformational role.



Regulators, on the other hand, need to provide clear policy ambitions and blueprints to guide the maritime industry, ports, financiers and investors. Regulatory examples from Singapore and China serve as beneficial guides in this regard.

Shipbuilders, engine manufacturers, naval architects and marine engineers all have a role to play in designing optimal ships for minimising the output of GHG and developing solutions to capture and store GHG. However, there are no contractual levers in typical shipbuilding contracts which might be adapted to encourage or produce a reduction in GHG emissions.

Clearly **shipowners, operators and managers** have a role to play in ensuring that the ships are equipped to meet net-zero commitments to flag, to the IMO, and to stakeholders such as their investors and customers.

Meanwhile, **charterers and cargo owners** also play an important part in this transition by choosing ships that use lower-impact fuels and driving the industry towards greener solutions. In particular, for customers pledging to achieve net-zero emission reductions, they need to align their actions with their commitments and create market forces that support decarbonisation. In doing so, this will also help them reach their goals and mitigate the risk of being accused of greenwashing.

Last but by no means least, **insurers** will play a pivotal role as they implement the Poseidon Principles for Marine Insurance (in the hull & machinery sector) and protection and indemnity insurers consider the risks associated with new fuels, retrofitted ships, speed and performance warranties.

Legal note

Shipbuilders
The carbon footprint of a ship as built will fall under its scope 3 emissions. Buyers of ships concerned to reduce the scope 3 emissions will need to reconsider the warranties and other obligations in shipbuilding contracts in particular the sources of materials and the carbon intensity of the construction process. Negotiating new clauses will be a challenge in an industry where the commercial power is frequently in the builder's hands.

Shipowners
Along with new fuels, shipowners will be considering the design of the hull, the types and uses of paints, wind propulsion and air lubrication, and carbon capture and storage in order to reduce the carbon intensity of their vessels. Some of the customisations will require new ships, others will be retrofitted. All of these will present complicated contractual relationships between shipbuilders, equipment manufacturers, shipowners, and charterers who are frequently involved in the construction oversight process. Lawyers advising any of the parties will need to have a complete overview of the varying risks and responsibilities.

Charterers
Shipowners are frequently concerned that charterers will simply look for the cheapest transport solution and leave commitments to net-zero to the shipowner to achieve. These differences in opinion have led to stand-offs in contractual negotiations. Nevertheless, cargo owners have taken an initiative to improve the role of charterers in addressing global environmental issues. Thus the Sea Cargo Charter was developed. This is a collective commitment between the signatories to assess and disclose the climate alignment of their ship chartering activities. The intent is to allow charterers to better align their chartering activities with responsible environmental behaviour. The four principles are:

· Signatories will calculate GHG intensity and GHG emissions annually;

· A common technical framework is adopted;

· Signatories will require a standard clause to be adopted in charterparties to obtain cooperation from shipowners; and

· The parties will publish their climate alignment scores annually.

More about Sea Cargo Charter can be found here: Sea Cargo Charter.

Insurers
Insurers will play a quiet yet pivotal role as the acceptance of new risks and the pricing of insurance premia will impact the ability of stakeholders in the maritime industry to do business. One area of concern is whether the concept of seaworthiness will be expanded to include "greenworthiness" i.e. that charterers may be able to claim damages from a shipowner if they considered that there was excessive carbon emissions during the transport of the cargo, or there were limitations on routing or access to ports due to carbon emissions. This may have a real financial impact with the advent of carbon trading for the maritime industry.

Bridging the Green Gap: A Common Language

If one of my vessels gets an E rating, it is going to be very hard for me to operate it in the market and find charterers to take her, because the new rule doesn't allow you to have a ship with an E rating for a very long period of time

- Shipowner

I would say that, in general, all financing going forward will need to have some ESG elements, in order to gain access to capital. It is not there yet at the moment, but I could see it coming potentially

- Financier

In China, we encounter the problem that the sockets for shore power vary across provinces and cities. After retrofitting my ship, I might be able to use it in one region, but there is no guarantee it will work in the next place. This is a bit annoying

- Shipowner

The Challenge

Banks and shipping companies face the challenge of accurately evaluating the environmental performance of shipping companies in structuring sustainability-linked loans.

Interviewees noted that finding comparable and consistent metrics for the shipping industry can help to direct financing effectively towards greener practices, while also safeguarding against accusations of greenwashing.

Solution Pathways

A promising solution might reside in the IMO's latest rating standards for the shipping industry. These standards include the Carbon Intensity Indicator (CII), Energy Efficiency Index for Existing Ships (EEXI), and Energy Efficiency Design Index (EEDI). Using these metrics as benchmarks for sustainability-linked loans and green loans could provide a consistent and convenient benchmark.

The IMO mandates all ships to calculate their EEXI and EEDI, and to annually measure, audit and disclose their operational carbon intensity using the CII rating. These new indicators can potentially serve as a common language for the maritime industry and the financial sector in driving greener practices.

The Challenge

This is an exciting opportunity for the maritime trade industry to shape its future through a systematic and collaborative approach, including addressing nuances like a universal standard for plugs and socket outlets for shore power worldwide. Shore power, despite being a mature technology introduced since the 1980s, is yet to be implemented universally at ports and ships around the world.

The discounts we received from banks by doing extra things on ESG for sustainability-linked loans or green loans are really marginal and it bugs me. It makes me question whether the banks are really in the game, or just saying that they are

- Shipowner

Solution Pathways

Switching to electrical power for ships at berth, rather than relying on diesel-burning engines, can significantly lower air and noise pollution, and reduce carbon emissions from ships. An illustrative parallel can be drawn with the world's journey towards agreeing upon a common charger for electronic devices, such as smartphones and laptops, culminating in the USB-C standard after more than two decades. In the same vein, the maritime industry could benefit from agreeing early on a standard for shore supply outlets as it continues to make shore power a common feature in all ports and vessels.

We have infrastructure in place for shore power. Some ships use it, but some don't because their ships are not equipped for it. For a period of time, we even offer shore power for free to promote its use

- Port operator

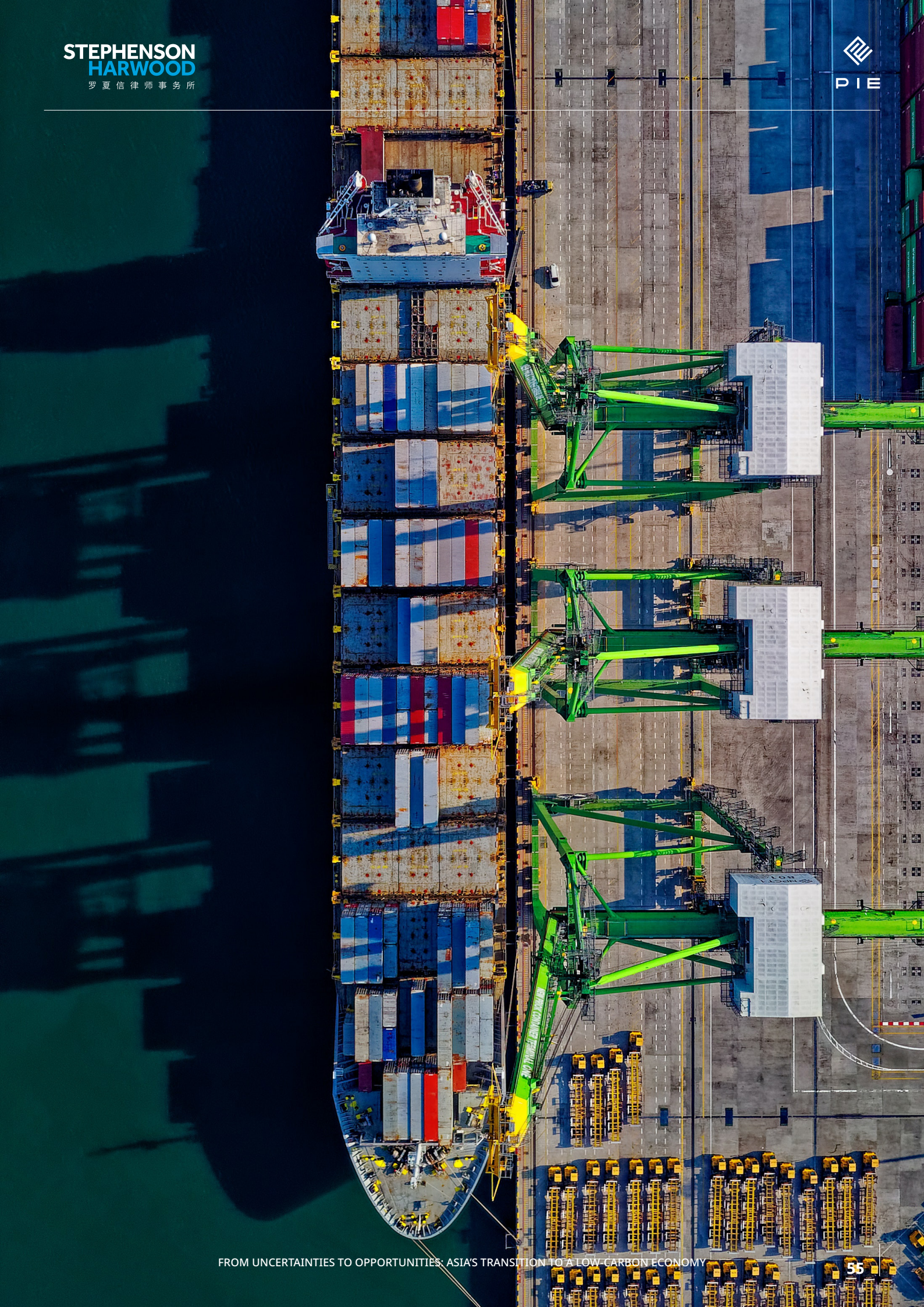
Legal note

In a fragmented industry dominated by contract, even implementing **carbon intensity indicator** (CII) in practical ways is very complicated. For example, in time charters the commercial operation of the vessel is the responsibility of the charterer. However, the CII reporting obligations, and the consequent grading of the vessel, are the concerns of the shipowner. The way in which the vessel is exploited commercially, the speed, the route and the waiting times ordered by the charterer all have an impact on the carbon emissions of the vessel. The shipowner cannot deviate from these instructions to improve the carbon efficiency of the vessel without breaching the charter. Clauses to help parties deal with this have been promulgated by various organisations such as BIMCO, but none have found universal acceptance.

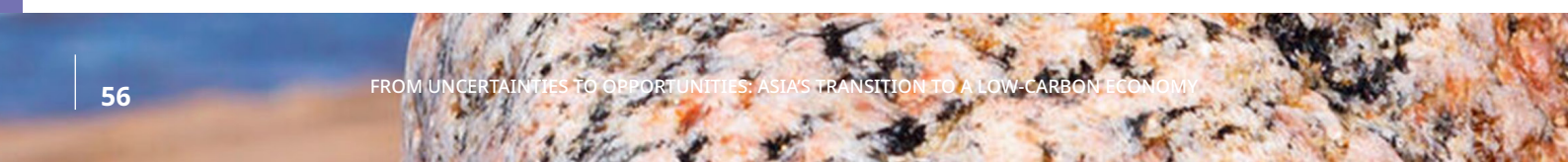
The Lessons Beyond

The case of the maritime industry serves as a harbinger of the challenges and opportunities that other asset-heavy industries might encounter in their journey to net-zero. Although we are still searching for fuel that can make an asset-heavy industry such as maritime lighter, we can make it smarter by leveraging data analytics and fast-evolving technology solutions.

The road to decarbonisation is undeniably complex and requires the collective strength of all industry players. Each stakeholder, regardless of their scale or role, holds the power to catalyse change, reduce risks and contribute to a sustainable shipping industry. As the maritime industry continues its voyage towards a zero-carbon future, the power of unity and collaboration cannot be underestimated.



Unlocking the Potential of Legal Services



The legal services sector plays an important role in this rapidly evolving landscape of climate-related policies, regulations and stakeholder expectations. While it is still uncertain how climate-related regulations might evolve, it is clear that there will be more, and more stringent regulations, particularly concerning emissions. Legal professionals can help clients anticipate these changes, aiding them to make informed business and investment decisions in an era of climate transition.

Fostering Regulatory Foresight: Guiding through Evolving Climate Policies

Particularly in sectors such as shipping – where contractual commitments often extend over a long period – legal services can fulfil a dual purpose. They do not only assist clients in meeting current regulatory demands, but also empower them to anticipate the trajectory of these changes. Such foresight can guide them in making informed investment decisions and forging business relationships that reflect this evolving landscape – a request made by some interviewees participating in this research.

Legal professionals are uniquely positioned to help their clients understand the current ESG regulations and potential future changes. It is crucial for clients to be aware of their duties regarding ESG compliance, as well as the potential risks and consequences of non-compliance.

This anticipatory guidance should also extend beyond local regulatory boundaries. Given the global nature of trade, companies might be required to meet ESG compliance requirements requested by foreign partners, such as those in the European Union. Legal advisors, therefore, can offer insights into these transnational dynamics concerning climate policy transition and help their clients navigate them adeptly.

They can help us comply with laws and regulations, and help us prepare to comply with laws and regulations, and not to be surprised in the middle of a contractual agreement. That, at least, is a very clear role for law firms in this space

- Asset Manager

In the process of negotiating and signing contracts, we need a lawyer to provide input on many different aspects, including carbon emissions ... this includes our leasing contract, compliance with IMO regulations on carbon emissions, the use of different fuels and insurance coverage.

For example, insurance may already be very mature in dealing with existing bunker fuels. However, if it involves some new energy sources, such as the safe storage and use of it, we need legal services that are forward-looking enough to examine these issues and advise us on how to protect our interests fairly and mitigate potential disputes related to decarbonisation

- Shipowner

Futureproofing

While lawyers are not soothsayers predicting the future, there are certain trends that can be highlighted which may lead to future regulation and changes in business practices.

In February 2022 the EU Parliament proposed the Corporate Sustainability Due Diligence Directive (CSDDD). Initially there was little belief that it would come into force as a directive. However, in May 2023, after debate, the CSDDD has been approved. This Directive, when it is implemented into national laws across the EU will require companies, not only to report and monitor the negative environmental impacts of their own activities, but those of their direct and indirect suppliers, as well as implementing programmes that align with the Paris Agreement guidelines. This is a significant departure from previous legislation and will impact Asian businesses as they interact with EU businesses. Asian businesses that do not comply with the CSDDD will be at a competitive disadvantage with those that do. CSDDD applies to non-EU businesses doing business in the EU and imposes duties specifically on directors to implement those strategies and integrate them into the corporate strategy of the business. Failure to comply will result in fines and compliance orders. Also victims impacted by any malpractices will be owed compensation. Businesses will need assistance from their legal advisors over the next two years as EU member states implement this Directive into their domestic legislation. Lawyers will also need to assess the risk to businesses of any actions being brought by potential victims and consider the exposure to damages.

The voice of the people

On 18 June 2023, the people of Switzerland voted in a referendum in support of a new climate bill designed to cut fossil fuel use and reach net-zero by 2050. The bill requires all companies (listed and non-listed) to have "zero emissions by 2050, direct and indirect emissions must be taken into account".

As an example of how this might impact the global economy – and have an impact on Asian businesses and investors consideration must be given to the commodity trading industry. About 500 Swiss commodity trading companies account for the sale and purchase of 60% of global agricultural products, 60% of global metals trade and 40% of the world's trade in oil. The majority of these products are carried by sea.

The GHG emissions of those ships are the indirect emissions – their scope 3 emissions. It will no longer be a matter of policy ambition to reach net zero – it will be a matter of law.

How this law interacts with other national laws, EU law and MARPOL will be complex with multiple conflicts. Scope 3 brings the reality of net zero to Asia, whether there is local provision or not. Legal advisors will need to have a deep understanding of international trade and of shipping in order to properly advise.

Cultivating ESG Literacy: An Imperative for Change in Internal Education

As with any other industry, law firms should invest more in internal ESG and climate education to build competence and engagement in these issues, linking them to existing legal practices and client duties.

Just as the mainstream investment sector grapples with understanding the differing perspectives and expectations of ESG versus sustainability, a similar need seems to pervade the legal services sector. ESG factors are crucial to investment, and operational risks and opportunities. Hence, it is critical for legal professionals to distinguish between the two, and convey the evolving ESG regulatory and disclosure compliance risks and consequences of non-compliance to their clients.

Additionally, this shift towards ESG literacy should start at the roots of legal education. Law schools and professors need to integrate ESG considerations into their curriculums to prepare aspiring legal professionals for the new demands of their future roles.

Legal counsel are just normal people, so we are no different from others. ESG is a new area and one that is evolving almost every day. I think if we believe in the importance of ESG, we should educate this internally and be informed of ESG developments to competently advise our clients on ESG risks or benefits

- Business

In overseas markets, there are impact-related legal terms, legal terms in relation to responsible investment. We lag behind in Asia. Some people have already done the hard work. Why can't we take reference from them and develop legal terms that fit our market. I want a legal partner who is competent in offering world-best practices, a leading model of impact investing – I would be excited [by that]

- Impact-concerned investor

Demystifying ESG: Towards Actionable Legal Advice

Navigating the climate transition is not about pushing an "activist" ESG agenda or only responding to regulations. Instead, it is about keeping clients informed of ESG-related risks and using legal tools to protect their interests.

The key to translating sustainability principles and ESG risks into practical legal advice lies in understanding the specifics of ESG in relation to different legal practices and clients' differing needs. Just as each client's business is unique, so, too, are the ESG challenges they face. It is this nuanced understanding that will remove potential mental blocks and allow the creation of actionable legal advice that truly serves the interests of each client.

Navigating Scope 3 Emissions: Legal Services Facilitating Fair and Value-Added Relationships

Rising expectations for climate-related disclosure and carbon emission reductions, particularly concerning Scope 3 emissions or value chain emissions, present the legal services sector with a unique opportunity to influence sustainable change and expand its scope of services.

A fundamental question from the insights of the interviews is about how goodwill principles, such as reducing the speed of sailing and optimising shipping route to contribute to emissions reduction, might be translated into accountable actions. Legal professionals can assist their clients in establishing fair and value-added relationships that uphold binding commitments to emission reductions.

Managing the 15 categories of Scope 3 emissions is formidable, which highlights the importance of the inter-dependencies, collaboration and accountability for driving systemic transition. How should we govern this collaboration and ensure parties are accountable for their share of responsibility in reducing Scope 3 emissions?

The legal services sector can help transform net-zero emission reduction commitments from goodwill gestures into tangible and accountable actions. This shift not only supports clients in fulfilling their commitments, but also aids in mitigating the risk of greenwashing allegations.

Navigating these complexities requires fair and binding agreements for managing emission reduction accountability in the value chain. By facilitating this process, the legal services sector can ensure these commitments extend beyond goodwill, translating into accountable action and value-added outcomes. Hence, they can contribute meaningfully to the transition towards a low-carbon economy.

Trading your way to zero

On 10 May 2023, the EU amended existing regulations to include maritime transport activities in the EU Emissions Trading System. The existing monitoring, reporting and verification (MRV) requirements for shipping emissions have been amended to enable the extension of the EU ETS to maritime transport activities, and provides for MRV of additional GHG emissions from additional ship types. From 5 June 2023 emissions from large commercial vessel will have to report emissions on journeys to and from an EU port. This will gradually be extended to smaller ships.

By April 2024 shipping companies will be required to submit monitoring plans, by 1 April 2024, for approval by the relevant administering authority and report verified aggregated emissions data.

Member states will be able to expel ships where the shipping company fails to comply with monitoring and reporting obligations for two or more consecutive reporting periods.

Shipping emissions will now be included within EU ETS. The allocation of allowances and requirements for surrender of allowances will apply to 50% of the emissions from journeys between an EU port and a non-EU port. Shipping companies will be required to surrender allowances on a phased-in basis between 2024 and 2026.

Shipping companies will be allocated a member state as their administering authority under the EU ETS, based on where the shipping company is registered or the number of EU port calls made by its ships. By 1 February 2024, the Commission will publish a list of shipping companies covered by the EU ETS and their administering authority.

Climate litigation and company value

In May 2023 a report produced by the Centre for Climate Change Economics & Policy and the Grantham Research Institute on Climate Change and the Environment [*Impacts of climate litigation on firm value May 2023, Misato Sato, Glen Gostlow, Catherine Higham, Joana Setzer and Frank Venmans*] plotted the share value of companies against climate related litigation. The report reviewed litigation in Europe and the US during the period 2005-21. It noted that there was a seemingly unstoppable rise in climate litigation cases and an evolution in the types of claims being brought. The cases progressed from cases seeking to penalise illegal activities such as deforestation and compensation for exacerbated damages caused by pollution, to more recent cases around breaches of fiduciary duties and climate action brought to advance effective action on climate change.

In conclusion the report demonstrated that there was a small but negative impact on share price in relation to the filing of claims, this was further exacerbated by a negative ruling. There was also a small positive impact on share price in relation to positive rulings. Although the impacts assessed were small, the trend was towards growing. In their estimation the average economic benefit of a positive decision was about USD197m and the average economic cost of a negative decision was about USD360m.

Climate related litigation is likely to be on the rise. In those circumstances it will be necessary not only for lawyers to assist in defending and/or bringing actions.

Research Design

This research's underlying methodology comprises inductive, qualitative stakeholder analysis through in-depth interviews. Grounded in the principles of purposive sampling, we engaged 26 key decision-makers and legal counsel based in Asia. The fieldwork for this research, adhering to the Chatham House Rules to facilitate an open and free exchange of information, was conducted between February and April 2023.

Participants' Representation

Our participant base was evenly distributed between two crucial sectors: the banking and finance and asset management sectors and private enterprises predominantly from the maritime and international trade sector.

Key Research Questions

The central objective of this research was to capture stakeholders' perspectives on the climate agenda's opportunities and challenges. We aimed to identify strategies that transform uncertainties, gaps and barriers to opportunities for businesses in the transition to a low-carbon economy. Additionally, the research was designed to examine the legal services sector's role in this transition. The investigation was guided by key research questions, including the relevance of decarbonisation and climate change to investors and businesses based in Asia, particularly in Greater China. It explored perceived drivers and barriers in the transition to a low-carbon economy and the potential roles that the legal services sector could fulfil to address these needs and bridge the gaps.

Acknowledgement

We extend our heartfelt gratitude to all the stakeholders who participated in this research. Their candid perspectives and professional expertise have been instrumental in shaping the findings and insights of this white paper. These anonymous contributors generously gave their time and trust, motivated by a desire to contribute to societal and sectoral benefits. They shared their views openly, allowing us to identify challenges and explore pragmatic solutions in our collective journey towards a low-carbon economy. We greatly appreciate their contributions and commitment to this crucial transition.

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About Stephenson Harwood

Stephenson Harwood is a law firm with over 1,300 people worldwide, including more than 190 partners. Our people are committed to achieving the goals of our clients - listed and private companies, institutions and individuals.

Our headquarters are in London, with eight offices across Asia, Europe and the Middle East. In addition we have forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service. We assemble teams of bright thinkers to match our clients' needs and give the right advice from the right person at the right time. Dedicating the highest calibre of legal talent to overcome the most complex issues, we deliver pragmatic, expert advice that is set squarely in the real world.

Decarbonisation and the drive to net zero affects every person and every business. With this transition comes both opportunities and challenges. Our cross-practice international team of lawyers at Stephenson Harwood can help you both navigate through these challenges and help your business to make the most of the opportunities no matter where you are on your journey.

In addition to advising on investment, structuring and financing arrangements, we have aligned ourselves to three integral pillars of decarbonisation that will help businesses chart a clear path to achieving net zero:

• energy

• transportation and trade, and

• the built and natural environment.

This gives our clients the benefit of cross-sector insights as we support them on their pathway to net zero.

For more information, visit www.shlegal.com and follow us on LinkedIn.

About PIE Strategy

A Best For The World™ B Corp, PIE Strategy is an impact-driven sustainability consultancy, specialising in providing independent, professional advisory services to corporations and investors across Asia.

Our team of sustainability strategists and specialists work closely with our clients to define customised pathways for embedding ESG considerations into corporate and product strategies that deliver sustainable growth, while driving better outcomes for people and the planet. We offer a range of technical services, from double materiality assessment, science-based target-setting, and climate scenario analysis, to product environmental life-cycle and social impact assessments. Our services equip businesses across Asia with the knowledge, tools and clarity necessary to connect business success with social progress and environmental conservation, and to communicate their contributions with relevance and authenticity.

We believe in collaboration. Through a research-driven and stakeholder-inclusive approach, we create unbiased, thought-provoking content that inspires dialogue and engagement to foster broader systemic change.

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