

## **SUISSENÉGOCE position paper** **MEPC-83**

### **CONTEXT**

SUISSENÉGOCE is grateful to the International Maritime Organisation (IMO) for its adoption of the *2023 IMO Strategy on Reduction of GHG Emissions from Ships* (Strategy). SUISSENÉGOCE particularly appreciates:

- the adoption of the Long-Term Climate Goals of the Paris Agreement in the Strategy;
- the definition of “striving for” targets that show a way to alignment with a 1.5-degree warming limit;
- the definition of 2030 targets that will encourage the prompt start of the energy transition;
- focus on just and equitable transition.

SUISSENÉGOCE encourages interpretations of the Strategy that will:

- adopt well-to-wake targets for emissions reduction;
- adopt life-cycle assessments of the fuels that are rigorous and science-based;
- adopt life-cycle assessments of the fuels that include rigorous assessment of direct and indirect land use change.
- send a strong demand signal to fuel producers to build world scale fuel production facilities for the production of **sustainably scalable ZNZs** (Zero and near-zero GHG fuels).

**SUISSENÉGOCE** notes the IMO’s workplan to define the mid-term measures (Measures) in support of the Strategy. SUISSENÉGOCE supports Measures that will deliver the Strategy in an effective and efficient manner. To this end, it supports Measures that meet the criteria set out below. These are not the only criteria that are important when evaluating the Measures. Other organizations are better placed to design criteria related to, for example, just and equitable transition. The SUISSENÉGOCE Criteria are:

- Investability;
- Flexibility;
- Practicability;
- Fairness.

## CRITERIA

### A. Investability

Investability is the ability of the Measures to drive investment in the assets needed for implementation of the Strategy.

Energy transition in shipping will require an investment of \$1500 billion to \$2000 billion in fuel production infrastructure and \$500 billion in additional shipping infrastructure. There isn't enough capital in the shipping industry to support this scale of investment. The Measures, therefore, have two tasks:

- to regulate the shipping industry;
- to attract new capital into the shipping and fuel supply industries.

Energy transition in the shipping industry will only happen if regulation is strong enough to perform both tasks. The latter task can only be achieved if the regulations have enough *power, robustness, clarity, and timeliness* to incentivize investors of capital from outside of the shipping industry to invest in its energy transition.

*Power* ensures that the Measures are sufficient to drive the shipping and fuel supply industries to the level of climate ambition and nature of just and equitable transition expressed in the Strategy. A powerful set of Measures will have targets aligned to the Strategy and economic incentives that are sufficient to invest in production of ZNZs (Zero and near-zero GHG fuels) at the necessary pace, scale and geographic distribution. This case is made clearly **in the paper ISWG-GHG 18-2-15 IMarEST.**

With regard to just and equitable transition, the Measures need to be powerful enough to enable economic actors in Less Developed Countries (LDC's) and Small Island Developing States (SIDS) to benefit from the new industries and technologies that will emerge as a result of the energy transition in the shipping industry. In this sense the Measures need to drive accessibility by the LDC's and SIDS to the benefits of energy transition.

**It is necessary to focus economic incentives on ZNZs** as there is insufficient volume of biofuel to support the Strategy. ZNZs are important in this context as they are the only fuels that can both meet the carbon intensity requirements of transition and be **sustainably scalable** across the shipping industry. ZNZs include e-methanol, e-ammonia, e-methane and the other hydrogen-based fuels. **The risks of overreliance on biofuels are well expressed in paper ISWG-GHG 18-2-21 by CSC.**

*(Note that the propulsive energy of wind assisted propulsion should be considered, in all regards, as equivalent to the propulsive energy of ZNZs). If the economic measures are insufficient to encourage ZNZs, they are insufficient to drive the energy transition.*

*Robustness* gives confidence that the Measures will, when applied in a commercial real-world environment, lead to delivery of the Strategy. This is achieved with: compelling sanctions for non-compliance, enforcement of those sanctions, and measures to minimize all forms of evasion. It is also achieved with the absence of measures that could otherwise pause or delay efforts to meet the targets, such as fuel-non-availability notices and fuel availability tests.

*Clarity* is the ability of the Measures to be understood, with confidence, by investors from outside of the shipping industry. Measures that are complex and/or subject to variables that are outside the control and/or understanding of such investors will have limited effect.

*Timeliness* is critical. It should be noted that rapid decarbonization in the 2030's requires final investment decision (FID) to be made on large scale fuel production projects in the mid 2020's. Any delay in giving a powerful, robust, and clear message to investors will impede the Strategy. It should be noted that 'world scale' fuel production projects take 7-10 years to plan, permit, construct, and prepare for

commercial operations. FIDs are required in the next few years.

Even in the event that large scale implementation of ZNZ fuels is only required in the late 2030's, the Measures will need to ensure the creation of pathfinder projects in the near term. These projects will enable the technological risks associated with production of new fuels to be managed ahead of scale-up. **Cost-down before scale-up** is an essential feature of an efficient transition.

## **B. Flexibility**

The Measures need to be open to multiple compliance options to allow industry to implement the Strategy in a practical way. Four dimensions of flexibility are required: *vessel based, geographic, aggregate demand and short term*.

*Vessel based flexibility* is required because not all vessels will be able to transition at the same pace at the same time. This limitation arises given the age profile of the fleet, the limited availability of retrofit facilities, and the unsuitability of certain vessel classes for retrofit. The Measures need to be open to methods of compliance that will enable vessels to transition at a variety of rates without compromising the overall compliance of the fleet.

*Geographic flexibility* is required as very low carbon fuels will not be available at all bunker locations at the same pace of energy transition, yet the transition must eventually happen in all regions and on all routes. Some bunker locations are likely to transition faster than others, for example due to reasons of scale of operations. The Measures need to be open to methods of compliance that will enable different bunker ports to transition at a variety of rates without compromising the overall compliance of the industry.

*Aggregate demand flexibility* is required as the supply of very low carbon fuels is unlikely to precisely match the demand through all stages of energy transition. Unlike the fossil fuel industry, which has sufficient fast switching supply capacity to short term changes in demand, the low carbon fuel industry can only add additional supply through very long-term projects. Changes in supply will significantly lag demand signals. The Measures need to remain open to methods of compliance that will enable vessels to comply even if there is an aggregate undersupply of compliant fuels, without compromising the power of the Measures to drive long term compliance with the Strategy.

*Short term flexibility* (a.k.a. a safety valve) is required to ensure that a vessel can remain compliant in the event that, for any reason outside of its operator's control, it is unable to bunker fuel that would ensure compliance. The Measures need to be open to methods of compliance that will enable vessels to comply even if there is short term shortage of compliant fuels suitable for that vessel, without compromising the power of the Measures to drive long term compliance with the Strategy.

## **C. Practicability**

*Doability* is the ability of the shipping and fuel supply industries to implement the Measures in a practical way and without creating unnecessary inefficiencies. In particular, the costs of energy transition need to be passed from the compliance entity (likely the vessel) to the end consumer via the cargo owner without adding unnecessary risk.

A key quality of practicability is *simplicity*, the Measures should be kept in the simplest possible form to minimize regulatory complexity and administrative burden.

A further quality of doability is *efficient allocation of risk*. Measures should allocate risk to those entities best able to manage that risk. To do otherwise is to unnecessarily increase the costs of transition as the private sector tends to highly price those risks that it must take but cannot control. Efficiency of risk

allocation will lead to efficiency of transition, minimising transition costs and minimising wasted levy and/or fees.

Key to the doability of transition will be the transparent, predictable, and prompt apportionment of risk. Risks need to be apportioned in this way for ship owning entities to transfer the risks and costs of transition along the supply chain to end-consumers and, where relevant, rebate providers and/or overcompliance buyers/sellers.

#### **D. Fairness**

The Measures should promote an energy transition that is fair among the industry participants that are engaged in the transition.

*Goal based:* The Measures should support adherence to the Strategy according to its goals.

*Technological neutrality:* The Measures should not favor one method of compliance over another, in this sense they should be technologically neutral among the multiple technologies that may be used for vessels to comply with the Strategy.

*Science based:* The selection of goals and targets for climate ambition, just and equitable transition and life-cycle assessment should be based on science as determined by relevant and independent experts

## **PROPOSED MID-TERM MEASURES FOR MEPC-83 (7-11 April 2025)**

Three Mid-Term Measure proposals have been submitted for discussion:

- 1) The first is set out in ISWG GHG 18-2-12 and 16-2-11 submitted by China, South Africa and United Arab Emirates. **This is a GFS+Flex proposal.**
- 2) The second is set out in paper ISWG GHG 18-2- 5 submitted by multiple nations including EU nations, Small Island Developing States, Less Developed Countries and the ICS. **This is a GFS+Flex+Levy proposal.**
- 3) The third is set out in paper ISWG-GHG 18/J/9. It is a **“bridging proposal”** that attempts to deliver the revenue generation capacity of a “levy” proposal from an architecture that looks like a GFS+Flex proposal. It was introduced by the Chair during ISWG 18 and is commonly referred to as the “Singapore Proposal”.

All three proposals modify Working Paper 9 from MEPC 82, all leave a substantial number of square brackets for material components of the basket-of-measures. The second proposal (EU, SIDS, LDCs and ICS) represents **a significant convergence of three groups** that had, until now, submitted proposals separately. This is supported by **more than 60 member states representing more than 50% of the GT of the global fleet**. This is an encouraging convergence of views among a diverse group of member states in all geographic regions and levels of economic development. It is likely that this group has the necessary majority to win a vote on the MARPOL amendment. That said, the objection to any form of levy from some member states remains strong and it is the preference of all to find a yet-broader consensus.

All three proposals contemplate a revenue body that distributes funds for multiple uses, including subsidies for Zero or Near Zero fuels (ZNZ), **but only the second has a mechanism to secure sufficient and stable funds for the early promotion of such fuels**. The ability of the “Singapore Proposal” to provide **sufficient and stable** funds for the IMO Net Zero Fund is in doubt, modelling is ongoing.

It should be noted that all proposals defer material aspects of the mid-term measures for conclusion in the “guidelines”. This diminishes the investability of the transition as agreement of the guidelines will be deferred until, potentially, 2027. Worse, the guidelines may be changed on an annual basis, removing investable certainty from the business cases of long-dated projects. This concern is, to some extent, expressed in MEPC 83-7-21 by CLIA and WSC. SUISSENÉGOCE makes the further observation that the need for ‘investability’ puts a further burden on the regulations.

### **Dis-proportionality**

All three proposals inadvertently favor fuel pathways that deliver quick wins of modest environmental benefit over those that deliver more ambitious climate reduction. This would occur due to the disproportionate relationship in the proposed Measures between actual emission reduction versus the regulatory benefit that they earn.

This disproportional benefit for low carbon-intensity (CI) reductions risks locking-out the adoption of decarbonisation pathways that would have otherwise incentivized a more efficient pathway to the complete implementation of the IMO’s climate targets. As such these Measures fail the “Power” criteria as they do not have incentives that are sufficient to invest in production of ZNZs at the necessary pace, scale and geographic distribution to support the strategy. Such investment will be excessively dependent on the distribution of funds from the IMO Net Zero Fund, and not motivated by the GFS + flex components of the Measures.

Any MTM that uses the Greenhouse Gas Fuel Standard (GFS) to determine the economic benefit/disbenefit of compliance by calculating the difference between the attained CI of a fuel, its GHI, and the GFS will suffer this problem. By putting the economic focus on a subset of the total emissions, the difference between the GFI and the GFS, rather than total emissions, the regulations create a material discrepancy between the number of units required/generated for/by compliance and the GHG emissions saved.

This example demonstrates how a fuel with low CI reduction, that does not meet the GFI target, is still granted a disproportionately large economic benefit:

*Assuming a GFI target of 57gCO<sub>2</sub>e/MJ WTW in 2035.*

*Using Heavy Fuel Oil (HGO), with an attained GFI of 95.5gCO<sub>2</sub>e/MJ, will generate 1.58 Deficit Units (Dus) per tonne.*

*By contrast LNG has a GFI 77.2gCO<sub>2</sub>e/MJ and would generate only 0.83 DU for an equivalent amount of energy to 1 tonne of HFO.*

**Although the LNG provides a 19% emissions savings the reduction in DUs is 48%, which also means the financial impact is reduced by 48%.**

It should be noted that one of the roles of the Measures is to encourage the private sector to invest in a way that is relevant to the whole pathway to zero – this is a central feature of our “power” criteria. The private sector typically finds this challenging; the time value of money and investment risks focus investor attention on the near-term. This causes the private sector to sometimes make investment decisions that are at odds with a more complete decarbonisation strategy. Even if carbon is priced correctly, a shortened investment horizon will inhibit the optimal pathway to zero.

It is regrettable that the proposed Measures have the exact opposite effect. Instead of lengthening private-sector vision, the disproportionality embedded in all the proposed Measures will shorten private-sector investment horizons on the near-term quick-wins described above. It does this by creating a benefit for fuels that close the gap to the immediate targets in the z-curve rather than, more proportionately, giving benefit to the fuels and their infrastructure that are relevant to the longer-term pathway to zero.

This shortcoming can be addressed through these adjustments:

- **Regulatory proportionality** – Ensure that the calculation of deficit units in the GFS framework corresponds directly to actual emissions reductions.
- **Limited banking of compliance credits** – Limit accumulation of surplus compliance units to one year, ensuring an incentive to transition to ZNZ fuels.
- **Exclusion of fossil fuels from generation of compliance credits**

These adjustments to the Measures are necessary to:

- protect a multi-fuel future in which the IMO maintains its longstanding practice of technological neutrality, instead of giving an artificial benefit to those fuels that offer only modest short-term gains.
- Ensure that industry has the necessary mechanism to invest for the long-term decarbonisation goals rather than quick-wins.

## Summary Tables

The following first table summarizes the three proposals. The second table evaluates the proposals against the SUISSENEGOCE criteria set out on pages 2-4. The third table indicates how each proposal could be improved.

**Table 1 : SUMMARY OF PROPOSALS**

	<u>China and al.</u>	<u>Austria and al.</u>	<u>Chair – ISWG 18 / J9</u>
Type	GFS+Flex	GFS+Flex+Levy	2-Tier GFS + Flex
Scope of GFS	TTW adjusted by WTT CO2	WTW all GHG on a CO2e basis	WTW all GHG on a CO2e basis
Stringency	A new proposal with two options with moderately lower stringency than the DNV proposal in MEPC 82 WP9.	As per MEPC 82 WP9 in which multiple options are open, including one proposed by DNV and another in which all targets are still to be discussed.	Not expressed
Flex	Pooling and trading as per MEPC 82 WP9 with either private or centralized pooling mechanism. Centralised trading at a “Reference Price” determined each year. Maths to be agreed in the guidelines.	Pooling and trading as per MEPC 82 WP9	As China et al. except there are two GFS lines.
Remedial Units	Reference Price plus premium.	Cost difference between the reference conventional fuel and compliant fuels, determined each year by a committee. Details in guidelines	Above the top line the Residual Unit (RU) is sized to incentivize decarbonisation. Between the lines the RU is sized to incentivize pay-to-pollute. Computation of these amounts is not defined.
Levy	None	\$18.75 or \$100 or \$150 per mt of CO2e WTW full lifecycle.	None
Additional sources of funds	Member state top-up. Transaction fees.	None	Not defined
Reward for ZNZs	To close the price gap between most cost-efficient GFS compliant fuel and the most cost efficient ZNZ, where ZNZ is defined by a low fuel CI that will be reduced on a phased basis.	To close price gap between “eligible ZNZs” and “other fuels”. Details to be determined in the “guidelines”.	Yes. Process not defined.
Support for R&D		Yes. Either in-sector -or- in-sector and out of sector.	Yes. Process not defined.
Support for Just and Equitable Transition		Yes. Either in-sector -or- in-sector and out of sector.	Yes. Process not defined.

**Table 2: ASSESMENT OF THE BASKETS OF MEASURES AGAINST THE SUISSENEGOCE SELECTED CRITERIA**

<u>Criteria</u>	<u>China and al.</u>	<u>Austria and al.</u>	<u>Chair – paper ISWG 18/J9</u>
1-Investability			
- Power	No. Stringency is high, but not sufficient to meet the targets set out in the Strategy. More importantly, the economic incentive is not strong enough to drive adherence to this path as the RU is set too low and the ZNZ reward not high enough. These incentives may be sufficient to promote uptake of LNG and biofuels, they will not incentivise scalable ZNZs.	Yes. Stringency is sufficient IF DNV trajectory is selected. More importantly, the economic incentive is strong enough to drive adherence to this decarbonisation path.	Yes if: <ul style="list-style-type: none"> <li>• The Z factors are defined as Austria et al.</li> <li>• ZNZs are sufficiently rewarded</li> </ul>
- Robustness	No. <ol style="list-style-type: none"> <li>1) Overreliance on guidelines for the key elements of the investment case for investment in ZNZs means that the transition is not robust.</li> <li>2) It will be necessary to ensure that the definition of ZNZ is strong enough to ensure that the fuels promoted by the reward mechanism can be <b>scaled sustainably</b>.</li> </ol> <p>A “ratchet mechanism” will be required to ensure that any shortcomings in certification schemes and the LCA of eligible ZNZs can be updated as challenges arise. The latter will be necessary to ensure that the reward mechanism does not incentivise counter-productive behaviours including land use change.</p>		No. In addition to the observations of the other two proposals, this proposal raises concerns about the sufficiency and stability of revenues for the IMO Net Zero fund. Moreover, attempts to control this revenue stream will result in volatile RU pricing: as the market prices for biofuels change, the RU pricing will have to change in order to continue revenue generation and decarbonisation. This instability of RU pricing will create an uninvestable environment for those fuels that require long-term investment in their supply chains, so incentivising use of fuels that are already established: biofuel and LNG.
- Clarity	Yes	Yes	No. See above.
- Timeliness	No – see disproportionality, and focus on “quick wins”		
2-Flexibility			
- Vessel level	Yes. Ability to pool or trade surplus / deficit units enables this.		
- Geographic	Yes. Ability to pool or trade surplus / deficit units enables this.		



- Aggregate demand	Yes. Ability to purchase RUs enables this.		
3-Do-ability			
- Simplicity	To some extent. These proposals rely on Fuel EU like mechanisms. All sectors of the industry will need to learn how to deal with this.	Complex and unstable. The structure will need frequent changes to RU pricing to maintain its ability to fund the IMO Net Zero Fund.	
- Efficient Risk Allocation	To some extent. These proposals rely on Fuel EU like mechanisms. This contains challenges in risk allocation between owner and charterer. With implementation of these regulations on a global scale, it is possible that a liquid compliance market will develop enabling efficient risk management/ allocation.	No. Unpredictability of RU pricing will inhibit use of forward-looking risk management tools. This will have a strong negative impact on the efficient operation of the industry as freight sellers will find it difficult to manage when selling voyages in future time periods.	

**Table 3: SUISSENEGOCE PROPOSALS**

<u>Problem/issue</u>	<u>Consequences</u>	<u>Proposals</u>
Definition of ZNZ not yet clear	Concern that the definition will be too broad and will not incentivize investment activities suitable for the complete energy transition	Reward for ZNZ must be clearly defined and restricted to <b>sustainably scalable ZNZ</b>
Stringency of LCAs and responsiveness to environmental impacts not foreseen by the analysis.	Unintended consequences having negative environmental impact. Particularly related to DLUC, ILUC and food security (feedstock)	Definition of ZNZ to exclude fuels with risk of DLUC / ILUC LCA process to include a “fast-track” update process to manage material, unforeseen, negative consequences that would otherwise have been considered under the LCA framework
Rewards for ZNZs in the guidelines	Guidelines will not be defined before 2026/27  Guidelines can be changed every year	The key components of the rewards for ZNZ must be defined in the regulations (formulas/principles)
Loopholes in certification mechanism for fuels	Possible impact on the environment if certification mechanisms are not clear and robust enough	“Ratchet mechanism” if negative impact on the environment is observed
TTW proposal does not include all GHG emissions	Methane and non-CO2 emissions are not accounted	Measure all upstream and downstream GHG emissions
Pricing of ZNZ reward is based on the current price of ZNZ that cannot readily scale	Uptake of ZNZ will be difficult because the reward is too low	Higher ZNZ reward: including incremental risk and cost of developing the infrastructure and vessel assets necessary to use them
RU price too low	Pay-to-pollute could be the most cost-effective method of compliance  Paying RUs will remain the best option compared to using fuels that will be rewarded	Higher price for RUs

<p>Dis-proportionality: fuels with low CI reduction are granted a disproportionately large economic benefit compared with those with a high CI reduction</p>	<p>Risk of lock-out of the adoption of decarbonization pathways leading to excessive reliance on the distribution of funds from the IMO Net Zero fund to drive the longer-term goals of the strategy. Not enough investment provoked by the GFS+Flex components of the Measures</p> <p>Shortens private-sector investment horizons on the near-term quick-wins, thereby not giving the necessary mechanism to invest for the long-term decarbonization goals.</p> <p>Does not contribute to a “multi-fuel” future as high CI reduction fuels are locked out early in the transition.</p>	<p>Regulatory proportionality: calculation of deficit units in the GFS framework must correspond directly to actual emissions reductions</p> <p>Exclusion of fossil fuels from generation of compliance credits</p> <p>Limited banking of compliance credits to one year to ensure an incentive to transition to ZNZ fuels</p>
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## Conclusions

To deliver the IMO 2023 Strategy, SUISSENEGOCE proposes:

- 1) Agreement of a levy proposal and therefore of the Austria et. al. proposal. It is the most likely to meet the Suisssenégoce criteria.
- 2) A clear and robust definition of the ZNZ in the regulations to ensure investability in the long-term goals of the energy transition.
- 3) An adoption of MTMs that enable the prompt uptake of ZNZs as well as the achievement of “striving for” targets.
- 4) Adjustment factors, if the TTW approach is adopted, that include all upstream GHG emissions.
- 5) A levy to ensure stable and sufficient funds for investment in ZNZs and the corresponding infrastructure development.
- 6) Strong and reliable certification and LCA (“quick response” and “ratchet mechanism”) to avoid DLUC, ILUC, and unforeseen consequences on food security and adverse impact on the environment.

- 7) Economic incentives that do not favor any technology/fuel over another.
- 8) Economic and regulatory incentives that address the Disproportionality issue.
- 9) Inclusion of most important elements of the Measures in the Regulations instead of the Guidelines, to ensure investability and predictability for future private-sector investment.
- 10) Support to a Just and Equitable Transition.