Developing an ESG framework: the how, the why and the when

MLAANZ Conference – October 2022

Geoff Farnsworth

13 October 2022

HOLDING REDLICH

Today’s session

- Why are we talking about ESG?
- What is ‘ESG’ in the context of transport?
- Unpacking Scope 1, 2 and 3 greenhouse gas (**GHG**) emissions
- International insights (Germany’s new Supply Chain Act (**GCSA** or **LkSG**); Blue Visby)
- Understanding ESG and supply chains: Grain Trade Australia
- Trends in global shipping – CO2 Intensity Indicator (**CII**)
- Q&A

HOLDING REDLICH

ESG is about legal and reputational risk

Is ESG over-hyped?

- Probably not
- Critical mass/’everywhere you look’
- Climate commitments now mandated
- But expect push-back (ie ‘woke’)

What is ‘ESG’ in transport and logistics?

ESG is a portmanteau that stands for the “Environmental, “Social” and “Governance” aspects of commercial activities. It is related to the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs)

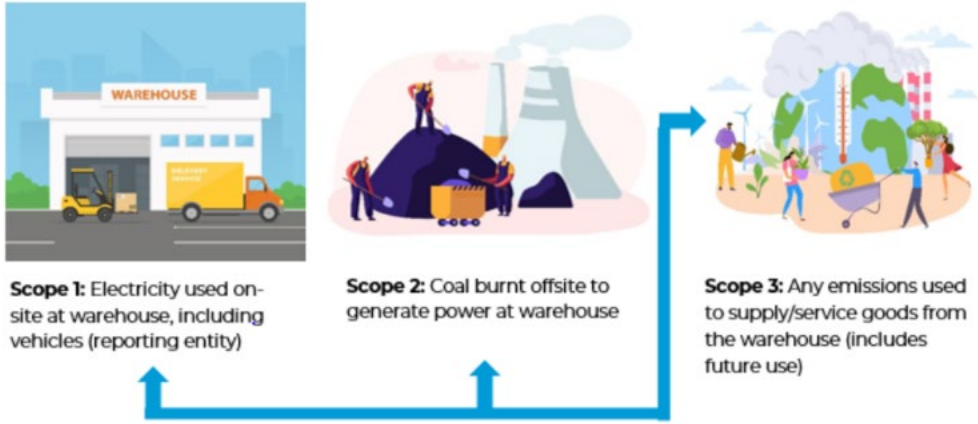
- Metric used by value conscious investors to evaluate risk in a company
- The main ESG transport industry risks are:

Environment	Social	Governance
▪ GHG emissions, reduced carbon footprint ▪ pollution, waste ▪ packing materials ▪ natural disasters ▪ resource scarcity ▪ renewable energy, clean technology ▪ biodiversity, ecosystems, responsible land use ▪ infrastructure, projects	▪ safety, welfare ▪ supply chains, forced labour, human rights ▪ work conditions ▪ labour shortages, port strikes ▪ cyber, data privacy breaches ▪ discrimination, diversity ▪ consumer demand ▪ community engagement	▪ government regulation, compliance, boards ▪ international, domestic laws, trade, sanctions ▪ risk management, increase/decreases in imports and exports ▪ price volatility in commodities, fuel prices ▪ fluctuation in freight rates, consumer demand

Unpacking scope 1,2 and 3 GHG emissions

Australian transport operators are required by law to report their GHG emissions due to environmental and health concerns.

- Categorised by 'scope' under the National Greenhouse and Energy Reporting Act 2007 (Cth) and Regulations 2008 (Cth) (**NGER Scheme**):
  - Scope 1 – 'direct' result of activity
  - Scope 2 – 'indirect' result of purchased energy
  - Scope 3 – 'indirect' result of **all** upstream/downstream activities in the supply chain (not in NGER Scheme)



HOLDING REDLICH

International insights: GSCA/LkSG due diligence

In June 2021, Germany passed the *"Gesetz über die unternehmerischen "Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten"*

- Also known as the *"Act on Corporate Due Diligence Obligations for the Prevention of Human Rights Violations in Supply Chains "* or "*Lieferkettensorgfaltspflichtengesetz*"
- Enters into force **1 January 2023**
- Imposes due diligence obligations on companies doing business in Germany to identify and mitigate human rights violations and environmental standards in their supply chains and establish effective risk management systems
- Applies to companies with principal place of business/administrative headquarters in Germany; **3,000** + employees in **2023** and **1,000** + employees in **2024**
- Serves to implement UN Guiding Principles of Business and Human Rights and OECD Guidelines for Multinational Enterprises
- Failure to comply = financial penalties, administrative fines and exclusion from award of public contracts

International insights: Blue Visby Solution

- Blue Visby™ has a sole purpose: to make shipping more sustainable by eradicating Sail Fast, Then Wait.
- “The Blue Visby Solution combines technology with long-established maritime traditions of cost-sharing, collaboration and mutuality.
- ”The Blue Visby Solution deploys the maritime industry’s own DNA and introduces the values of neutrality, independence and integrity to enable a new and environmentally better way of doing things.”
- https://bluevisby.com/how-does-it-work/

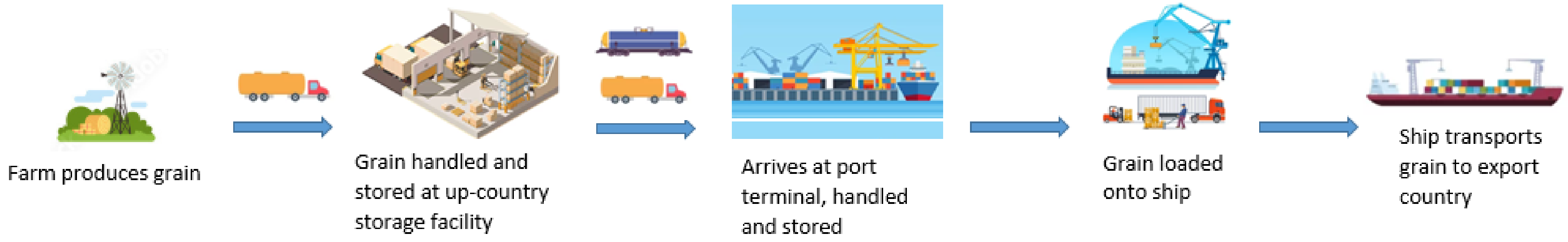
Blue Visby Solution

- The Blue Visby Operations System monitors four sets of parameters in a dynamic way – (a) individual vessel specifications and performance; (b) the specifications and performance of all other ships sailing to the same destination; (c) port congestion at the destination and (d) environmental conditions (weather, currents, swell, bathymetry, tides) – and communicates to the vessels their optimal arrival time calculated by the Blue Visby algorithm, while keeping their order of arrival as if they had sailed independently without the involvement of the Blue Visby Solution.

- The participants of the Blue Visby Solution incorporate into their charter parties and cargo sale contracts a set of terms that implement the Blue Visby Operations System and Blue GA, which create the contractual basis for the operational system of the Blue Visby Solution. They also become members of an association modelled on Protection & Indemnity Clubs, the Blue Visby Mutual Association, which regulates the relationships amongst participants, and administers Blue GA, with complete independence, neutrality and integrity.

ESG supply chain ‘deep dive’: GRAIN TRADE AUSTRALIA

Most of Australia’s wheat, barley and canola production flows through a bulk grain handling system:



- Scope 1 – from the farm (methane from livestock and manure (produced from feed (grain, hay, silage), includes use of diesel and petrol to fuel vehicles/trucks
- Scope 2 – from the grid that supplies electricity to the farm or up-country storage facility
- Scope 3 – used to transport the grain by truck or rail and includes all retail, processing and future distribution
- Different methods of transportation = different carbon footprints (hybrid haul trucks with lithium-ion and hydrogen batteries on the agenda)

Trends in shipping – CO2 Intensity Indicator

The Carbon Intensity Indicator (**CII**) is a rating system for ships developed by the International Maritime Organisation (**IMO**)

- Measures how efficiently a ship transports goods or passengers over time and is given in grams of CO2 emitter per cargo-carrying capacity and nautical mile
- New operational requirement to address IMO’s GHG emissions strategy to reduce CO2 emissions towards **40% by 2030** and **70% by 2050**
- Will soon be a mandatory measure under MARPOL Annex IV, expected to enter into force in 2023
- Part of IMO’s new CO2 regulations alongside:
  - Energy Efficiency Existing Ship Index (**EEXI**)
  - Ship Energy Efficiency Management Plan (**SEEMP**)

‘E’ investment and transition to net zero –

- Focus of investment in the renewables and sustainability sectors is moving towards supply chain and net zero operations due to:
  - Large-scale renewables slowing due to grid issues
  - Battery and storage systems still largely expensive to install and operate for major projects
  - Hydrogen technology still in pilot mode
- Sustainability ratings and net zero requirements have become standard evaluation criteria for most new contracts/tenders/infrastructure projects.

Q&A time

Geoff Farnsworth
Partner

T (02) 8083 0416
geoff.farnsworth@holdingredlich.com

HOLDING REDLICH