THE EUROPEAN UNION APPROACH TO COP26

13 September 2021 | Insight
Legal Briefings

EUROPEAN UNION AIMS FOR COP26

The European Union (**EU**) has made it clear that it aims to translate ambition into action at COP26. One aspect of this will be encouraging major emitters to submit their Nationally Determined Contributions under the Paris Agreement (for more information on Nationally Determined Contributions, please see here). It also seems that the EU does not only want to implement its agenda (eg in Europe through the 'Fit for 55' package) but it also wants to propose it around the world. The EU has recognised and acknowledged that as it is only responsible for around 10% of global emissions, significant reductions in global emissions will require global cooperation.

CURRENT COMMITMENTS

The European Union has continued to position itself as a leader in climate change and decarbonisation in the approach to COP26, which will be held in Glasgow in November 2021.

The European Union has been working to facilitate the clean energy transition within Europe for a number of years. In 2016 the European Commission rolled out the Clean Energy for all Europeans package which was successfully adopted in May 2019 following the adoption of eight legislative texts in four different energy packages.

The European Union went further in December 2019 with the European Green Deal which provides for the EU to become the first climate neutral continent by 2050, resulting in a cleaner environment, more affordable energy, smarter transport, new jobs and an overall better quality of life. A key deliverable under this was the European Climate Law (Regulation (EU) 2021/1119): adopted on 30 June 2021, the European Climate Law has created a legally-binding target of net zero greenhouse gas emissions (**GHG**) by 2050 (previously 80%), as well as an interim target of 55% reduction of emissions (previously 40%) compared to 1990 levels by 2030.

An updated EU NDC, reflecting a 55% reduction in greenhouse gases by 2030 against a benchmark of emission levels in 1990, had already been submitted to the UNFCCC in December 2020.

REGULATORY FRAMEWORK AND PROPOSED REFORM

In light of these ambitious targets introduced by the EU Climate Law, the European Commission announced a suite of legislative proposals in July 2021 in order to accelerate its climate action and to ensure that existing EU legislation was in line with these increased targets, and therefore fit for a 55% emission reduction by 20230 (the '**Fit for 55**' package).

The European Union has recognised that emissions reductions on this scale can only be achieved by taking action across a significant number of sectors. The 'Fit for 55' proposals are therefore wide in scope and varied in [approach?]. These proposals (some of which are explored briefly below) are likely to strongly influence and guide the EU's approach to, and aims for, COP26 (see below).

Renewable Energy

The energy sector is responsible for over 75% of the EU's greenhouse gas (GHG) emissions. An increase in the share of renewable energy across different sectors is a key focus for the EU, as it is essential to reducing emissions and achieving the EU's climate objectives. The development of renewable energy across the EU is largely governed by the Renewable Energy Directive, which was recast in December 2018 (2018/2001/EU). The 'Fit for 55' package proposed a number of amendments to the recast Directive, including an increase of the binding overall renewables target from 32% to 38-40% by 2030.

For further information on the proposed amendments to the Renewable Energy Directive, please see our previous blog post here.

Emissions Trading

The EU Emissions Trading System (**EU ETS**) is a key tool used by the EU to reduce its GHG emissions. Implemented by Directive 2003/87/EC, the EU ETS entered into force in 2005 and was the world's first international emissions trading system. It is a cap and trade system, which currently covers around 40% of the EU's GHG emissions.

The EU ETS has been implemented across a number of Phases. Currently in Phase IV, each Phase of the EU ETS has seen an expansion in its scope (whether countries, sectors or gases covered). Phase IV, which came into force in 2021, saw a further tightening of the emissions trading regime. For example:

- The cap under the EU ETS (ie the total number of permitted emissions) reduces annually, which is known as the annual linear reduction factor. For Phase IV of the EU ETS, this has been set at 2.2%;
- Certified Emission Reductions (**CERs**) issued as part of the Clean Development Mechanism under the Kyoto Protocol can no longer be used as a credit in the EU ETS; and
- A reduced Carbon Leakage List of 'high risk' sectors entitled to free allocation came into force, with free allocation to be phased out for less exposed sectors by 2030.

As part of its 'Fit for 55' package, the Commission has proposed a revision to the EU ETS in order to ensure that the EU can achieve its legally binding target of 55% reduction in its GHG emissions by 2030. The key changes proposed by the Commission include expanding the scope of the EU ETS to cover maritime transport and increasing the linear reduction factor to 4.2% (from 2.2%, as explained above). The EU has also proposed to introduce a separate emissions trading scheme for buildings and road transport.

For further information regarding the proposed changes to the EU ETS, please see our previous post here.

Carbon Border Adjustment Mechanism

The Commission's proposal for a carbon border adjustment mechanism (**CBAM**), aiming help to protect against the risk of carbon leakage, is currently subject to international debate both within the EU and beyond.

The proposed CBAM would require importers of certain goods to purchase certificates to cover the total embedded emissions (defined as direct emissions) of the relevant goods so as to cover the difference between the carbon price imposed on EU manufacturers of the relevant goods and the lack of or lower carbon pricing in the relevant third countries.

Each CBAM certificate would cover one tonne of embedded emissions. The price of the certificates would be benchmarked against the weekly EU ETS price, although the draft CBAM regulation does provide for a price reduction mechanism in order to take into account: (i) the carbon price paid in the country of origin; and (ii) any free allocation that EU producers of the same goods would be entitled to.

Although not all sectors on the Carbon Leakage List under the EU ETS are within the scope of the CBAM, there is a large degree of overlap: goods within the scope of the CBAM include cement, steel, iron, aluminium, electricity and fertilisers.

The CBAM is intended to come into effect (subject to transitional provisions) from 1 January 2023, however, it is currently subject to the EU legislative process and this date may therefore be subject to change.

For further information regarding the proposed CBAM, please see our blog post here.

Energy Efficiency

The EU has worked to promote energy efficiency and energy savings for a number of years, primarily through the Energy Efficiency Directive (**EED**) (2012/27/EC), which first entered into force on 4 December 2012 and was partially revised in 2018 (Directive 2018/2002/EU). The 'Fit for 55' package aims to align the EED targets with the EU's goal of climate neutrality by 2050. The proposed revision of the EED therefore introduces a higher target for reducing primary (39%) and final (36%) energy consumption by 2030, an increase compared to the current target of 32.5% for both. Other proposed amendments include the introduction and extension of certain obligations on public bodies with regards to energy efficiency, such as an obligation to take into account the energy efficiency requirements in public procurement activities.

For further information regarding the proposed revision of the EED, please see our previous blog post here.

Energy Tax Directive

The 'Fit for 55' package also included proposed amendments to the Energy Tax Directive, which aim to remove exemptions and incentives for the use of fossil fuels (eg in EU aviation and maritime transport) while promoting clean technologies. The proposal increases and adjusts minimum rates for energy products and electricity. The proposed rates are intended to reflect the energy sources and their environmental impact: they are designed to ensure that the most polluting fuels are taxed the highest.

For further detail on the proposed reforms to the Energy Tax Directive, please see our blog post here.

REPORTING FRAMEWORK

Corporate reporting and wider efforts to increase corporate transparency have been central areas of regulatory attention and wider discussion over the past years, with growing support for the Task Force on Climate-related Financial Disclosure (TCFD) Recommendations taking centre stage in many countries. In the EU the Non-Financial Reporting Directive (Directive 2014/95/EU) (**NFRD**) has driven corporate reporting since 2014 with a revision currently under review. The Taxonomy Regulation which focusses on the sustainability of business activities, marks another initiative aiming to drive transparency efforts within the EU, but as opposed to the NFRD does this from an investment perspective.

Non-Financial Reporting Directive

The NFRD, which came into force on 5 December 2014, sets out the rules on disclosure of non-financial and diversity information by large public-interest companies with more than 500 employees. Following guidance from the EU Commission in 2019, the NFRD and TCFD align to a considerable extent. The European Commission launched a consultation in relation to a review of the NFRD which closed in 2020. Although a progress report was published in October 2020, in April 2021 the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (**CSRD**) which would amend the requirements of the NFRD.

The proposed CSRD would extend the scope of the NFRD requirements to all large companies (whether listed or not) without reference to an employee threshold, as well as all listed SMEs (except for micro-enterprises). It is estimated that the number of companies subject to these reporting requirements would increase from 11,000 under the NFRD to 50,000 under the CSRD.

The CSRD proposal introduces more detailed reporting requirements, as well as a requirement to report according to mandatory EU sustainability reporting standards. It is envisaged that these standards would be developed by the European Financial Reporting Advisory Group and aligned to EU policies. It is anticipated that the first set of these standards would be adopted by October 2022.

EU Taxonomy Regulation

The Taxonomy Regulation (Regulation 2020/852) establishes a classification system to determine whether an economic activity qualifies as environmentally sustainable. The overarching Taxonomy Regulation, which entered into force on 12 July 2020, sets out four overarching conditions that an economic activity has to meet in order to qualify as sustainable. It also sets out six environmental objectives: (i) climate change mitigation; (ii) climate change adaptation; (iii) the sustainable use and protection of water and marine resources; (iv) the transition to a circular economy; (v) pollution and prevention control; and (vi) the protection and restoration of biodiversity and ecosystems.

Under the Taxonomy Regulation, the Commission is to adopt technical screening criteria for each of these environmental objectives through delegated acts. The Commission adopted a delegated act in relation to the first two objectives on 4 June 2021. A delegated act for the other four environmental objectives above is expected to be published in 2022.

For further information on the EU Taxonomy Regulation, please see our previous blog posts here and here.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

SILKE GOLDBERG
PARTNER, LONDON

+44 20 7466 2612
Silke.Goldberg@hsf.com

JANNIS BILLE
ASSOCIATE, LONDON

+44 20 7466 6314
jannis.bille@hsf.com