CADWALADER

January 3, 2023

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Happy New Year!

January 3, 2023

Welcome to the first edition of Cadwalader Climate in 2023. For those new to CC, we publish each week on Tuesday and Friday morning. Our goal is to describe and provide insight into the legal and business impacts of recent sustainability developments. We try to do this in a straightforward, concise and understandable way. We email CC to our distribution list and post it to the **CC website** and LinkedIn where you can also find all back editions. We hope you find it useful, and be on the lookout for our forthcoming piece on the top climate developments of 2022.

COP15: The Global Biodiversity Framework

January 3, 2023

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The United Nations Biodiversity Conference (COP15) ended in Montreal, Canada, on December 19, 2022 with a landmark agreement to protect at least 30% the planet's lands, inland waters, coastal areas and oceans by 2030 (known as the "30x30" target). The **Kunming-Montreal Global Biodiversity Framework (GBF)** was adopted by almost 200 countries after intense final negotiations. European Commission president, Ursula von der Leyen, said the agreement was a "Road map to protect and restore nature" that complemented the climate change mitigation-focused Paris Agreement. Unlike the Paris Agreement, however, the GBF is not legally binding. Controversy emerged during the negotiations as several African nations complained that the final version of the framework was pushed through without debate. The Democratic Republic of Congo, although it did not object formally, expressed unhappiness over the deal, while Uganda described the approval process as a "fraud" and a "coup d'état." Responding to criticisms, China's environment minister and COP15 president, Huang Runqiu, stated during the final UN session that he had tried his "best to bring . . . a balanced package" and that "after so many years of difficult negotiations . . . there's no magic formula that allows all of us to be completely happy."

The main area of contention involved how to pay the costs that will be incurred to realize the GBF's goals. The parties ultimately agreed to establish a global biodiversity fund with contributions of $20 billion/year by 2025 and $30 billion/year by 2030 from the existing United Nations Global Environmental Facility (GEF). China, Brazil, Indonesia, India and Mexico currently receive the largest amounts from the GEF. While some COP15 attendees expressed disappointment at the amount of these planned distributions, Japan, the EU and certain other countries objected to creating a new separate biodiversity fund, arguing that existing environmental funding mechanisms are sufficient. The EU has already pledged €7 billion towards biodiversity conservation between 2021 and 2027. The GBF adds to this effort by including pledges to cease at least $500 billion a year of subsidies for activities deemed harmful to nature such as agriculture and fishing.

The GBF sets forth four goals in furtherance of a 2050 Vision for Biodiversity as well as 23 targets for 2030. These four long-term goals aim to (A) preserve, restore, and increase the area of natural ecosystems, halt human induced extinction of known threatened species and reduce extinction risk of all species; (B) sustainably use, maintain and restore biodiversity; (C) share "the monetary and non-monetary benefits from the utilization of genetic resources, and digital

sequence information on genetic resources, and of traditional knowledge associated with genetic resources," and preserve and increase access to knowledge of genetic resources; and (D) develop, secure and support the technology needed to implement the GBF and ensure access for all parties, particularly developing companies. The 23 shorter-term targets call for urgent action to reduce threats to biodiversity, improve sustainable use of natural resources, and develop and distribute solutions and tools to enable all people to promote sustainable consumption.

The agreed framework has received mixed reactions. The World Wildlife Fund stated that it is "particularly concerned by the weak language on species which would commit countries to halting extinctions at some point before 2050, instead of 2030," while the Nature Conservancy's Director of Global Policy, Institutions and Conservation Finance, Andrew Deutz, stated that "if more people grasped the pace, severity and long-term implications of biodiversity loss, the eyes of the world might have been focused on Montreal rather than [the World Cup in] Qatar over these two weeks. Against a backdrop of dramatic ecological declines in the face of human-driven pressures, the world badly needed CBD-COP15 to deliver – and, right at the death, it did just that, scoring a win for people and nature ... Make no mistake: this is an historic result for nature. The Kunming-Montreal Global Biodiversity Framework provides a long-needed international blueprint to guide our collective turnaround of nature's fortunes within this crucial decade." Katie Leach, head of biodiversity at responsible investment NGO ShareAction, complained that the agreement was vague in certain areas and "non-specific targets in parts of the agreement could undermine the urgent action that's needed to protect threatened wildlife and ecosystems." Leach also stated that the success of the GBF would be measured by its "implementation and how the goals and targets are interpreted at a national level."

Taking The Temperature: COP15 went a long way toward cementing nature and biodiversity concerns as a permanent feature of the sustainability discussion. While much of the general interest in sustainability focus historically has been on climate change mitigation and adaptation—the heart of the Paris Agreement and the recently concluded COP27 in Egypt where the parties established a historic loss and damage fund to compensate developing nations for climate-related harms—biodiversity has received relatively less attention. Regulators, standard-setting organizations, NGOs and industry, however, increasingly are focusing on biodiversity disclosure, risk and opportunity governance and impact assessment, as we have reported in describing reports on financial institutions' biodiversity policies, EU deforestation legislation, the Task Force on Nature-Related Financial Disclosures' latest recommendations, and regulatory guidance suggesting the need for banks to consider biodiversity risk and impact in decision making. In our view, from the perspective of issuers and their boards, it is difficult to conceive how to separate material biodiversity and nature-related risks, opportunities and impacts from any other sustainability concern or other material development. Companies that pay insufficient attention not only to the potential impacts of climate-related nature developments on their business, but also their own impacts on nature (and, with them, possible boomerang effects on the companies themselves) risk missed opportunities to mitigate future harm and reap potential benefits associated with climate transition.

Regulation: EU Reaches Agreement on Carbon Border Tax

January 3, 2023

Regulation

By Sukhvir Basran
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Environmental regulators and ministers from across the EU member states **provisionally approved** the introduction of the world's first major carbon border tax, the Carbon Border Adjustment Mechanism (CBAM), which will require foreign exporters to the EU to pay for the cost of their carbon emissions. Imports into the EU of iron, steel, cement, aluminum, fertilizer, electricity generation, hydrogen and certain iron and steel products will be subject to the tax. The costs of carbon emissions for purposes of the tax would be calculated based on the actual Scope 1 and Scope 2 emissions that occur in the production of goods—defined as "embedded emissions." If actual emissions cannot be verified, the embedded emissions will be determined by the "default value," which is "based on the average emission intensity of the 10 per cent worst performing EU installations for that type of goods."

It is anticipated that the European Council and European Parliament will formally approve the CBAM, which will then become EU law. The tax will phase in gradually, with exporters initially having to provide emissions data starting on October 1, 2023. Peter Liese, lead negotiator for the European parliament, stated that the CBAM was "the biggest climate law ever in Europe, and some say in the world."

As part of the same package, policymakers also agreed to raise the emission reduction targets in industries covered by the European Emissions Trading System (EETS) to 62% by 2030 from the existing target of 43%. The EETS facilitates a "polluter pays" model by allowing electricity producers and energy-consuming industries a fixed amount of free pollution credits per year but requiring them to purchase additional credits to cover any excess carbon emissions. Companies that do not use all of their free credits can sell them. The number of available credits decreases each year. The new plan requires these covered sectors to significantly increase emissions reductions, in part, by reducing the allocation of free credits and completely phasing them out by 2034. The EETS currently covers emissions in energy-intensive sectors including cement, aluminum, iron and steel. The CBAM applies only to emissions *not* covered by the free allowances of the EETS. Furthermore, the lawmakers agreed to establish a Social Climate Fund to assist vulnerable households, small businesses and transport users in managing the impact of carbon pricing on energy costs.

The anticipated enactment of the tax has engendered controversy. Some of the EU's major trading partners have stated that it will expose affected industries to unfair competition. The United States and South Africa have expressed concern that the CBAM will penalize their manufacturing industries in having to compete with cheap imports from companies unwilling to pay the EU's tax and that instead will seek to export to other markets instead. Adina Georgescu, energy and climate director at the metal industry trade body Eurometaux,

expressed that lawmakers must “find a solution for keeping our exports competitive” and that “companies cannot afford further revenue loss and uncertainty on top of today’s existential energy crisis threat.”

Marian Jurečka, environment minister for the Czech Republic, which currently holds the rotating presidency of the EU, stated that the agreement “will allow us to meet climate objectives within the main sectors of the economy, while making sure the most vulnerable citizens and microenterprises are effectively supported in the climate transition.”

Koen Coppenholle, CEO of Cembureau, an EU cement trade association, stated that “we are still waiting to see the final details of the agreement, but from our perspective a strong CBAM is important to create a global level playing field on carbon dioxide emissions and support our sector in its transition to carbon neutrality.”

Taking the Temperature: The announcement of the carbon boarder tax is significant. Assuming it is implemented in its current form, which is still somewhat uncertain due to the ongoing debate over compliance with World Trade Organization (WTO) rules, there may well be push back from countries affected by the tariffs. As made clear by Dutch MEP Mohammed Chahim, the CBAM is seen by EU policymakers as “one of the only mechanisms we have to incentivize our trading partners to decarbonize their manufacturing industry.” It seems likely that the tax will be implemented in one form or another to enable the EU to bring direct commercial pressure on trading partners to reduce their reliance on fossil fuels. As we suggested in our article on EU legislation relating to deforestation, affected industries and companies should take steps now—even if the full implementation date of the legislation is still some way off. Companies should consider the impact this will have both directly on their products and on their supply chain as the increased costs will likely be passed onto them. Furthermore, they may see a reduction in availability as some non-EU suppliers decide to sell their products in alternative markets to avoid the regulatory burden.

Investing: Dutch Bank Publishes Climate Strategy and Joins NZBA

January 3, 2023

Investing

By Timbre Shriver
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On December 16, the Amsterdam headquartered bank ABN AMRO **announced** the publication of a **climate strategy** and its decision to join the Net Zero Banking Alliance (NZBA). ABN AMRO stated that it is "committed to making a difference" and that "sustainability has been core to our strategy since 2018." The bank announced a net-zero target for its own operations of 2030, and established 2030 targets for reducing financed emissions in the five largest sectors of asset classes on its books: oil & gas, power generation, shipping, commercial real estate and mortgages. To develop its targets and methodologies to meet the targets, the bank set forth a framework of eight criteria to measure its baseline and monitor its progress. Additionally, the bank offered a roadmap for expanding emissions reduction targets to other sectors. ABN AMRO also stated that it aims to increase its lending commitment to renewables and decarbonization technologies to at least EUR 4 billion by 2025 and that by 2030, up to EUR 1 billion in early-stage capital will be allocated to speed up the transition to a decarbonized economy.

The NZBA now has over 120 member banks from 41 countries representing 40% of global banking assets. Members of the NZBA are required to declare decarbonization targets within 18 months of joining the alliance.

Robert Swaak, CEO of ABN AMRO, stated in the foreword to the climate strategy document that "we know we cannot do this alone and will continue to team up with other stakeholders and other banks, sharing expertise and fostering cross-sector collaboration between our clients and other partners. Our commitment to sustainability in these past years has significantly enhanced our expertise, but to deliver on our climate strategy we need to step up our knowledge and capabilities. We will further broaden our wide range of in-house learning solutions, supported by partners. We are committed to supporting the transition to a net zero economy by 2050 and our climate strategy is an important step in accelerating our journey. We look forward to working with you on this major challenge for us all."

Taking The Temperature: ABN AMRO is only the most recent among major financial institutions to announce emissions-financing reduction targets and membership in industry climate collaborations. At the same time, in the U.S., those same industry collaborations are being challenged on antitrust grounds and—to the extent members adopt climate-related goals—as antithetical to appropriate investment considerations, by certain primarily Republican Southern and Western state finance officials. In our view, in discharging fiduciary duties to clients, financial firms that manage client assets have to consider all issues material to an investment, whether related to climate issues or not. Turning a blind eye to one subset of material issues, in this case climate-related

impacts, not only is illogical but also likely runs counter to fiduciary obligations. Nonetheless, we expect such politicizing of climate-related issues to continue in the U.S. even though, from a financial and legal perspective, objections from the "anti-ESG" side ring hollow.

Greenwashing: Switzerland to Establish Narrower Definition for Sustainable Investments

January 3, 2023

By Simon Walsh
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The Swiss Federal Council has **published** a position paper on the "prevention of greenwashing in the financial sector." The Federal Council is composed of seven members—each a head of a government department—who, collectively, serve as the executive body of the Swiss government. The paper clarifies that financial products may only be labelled as sustainable or as having sustainable characteristics if they (i) align with one or more specific sustainability goals, or (ii) contribute to achieving one or more specific sustainability goals. Sustainability goals should be defined "using the widest possible reference framework," and the paper refers by way of example to the Sustainable Development Goals in the UN's 2030 Agenda for Sustainable Development. Institutions offering sustainable products will be required to describe their approach to classifying a product as sustainable and report on their sustainability goals regularly, and such disclosures should be public, easily accessible, transparent and comparable.

The Federal Council instructed the Federal Department of Finance (FDF) to establish a working group, which will include "representatives from the affected industries and civil society," with the goal of establishing the most effective way to implement the Federal Council's position as set out in the paper. The Federal Council expects the FDF to present a plan with concrete proposals by September 30, 2023.

The position paper states that: "the Federal Council considers it essential to ensure that the necessary clarity exists to enable clients, investors and insured persons to make investment decisions about financial products or services that are described as sustainable. The Federal Council therefore sees a need for a common understanding in the financial sector about the general criteria permitting investment objectives, and hence products and services, to be labelled as sustainable. Inherently, this cannot involve detailed prescriptions, but only a baseline understanding. This common understanding of sustainability goals should apply to the entire financial market, financial services (both at the point of sale and in downstream reporting) and financial products (both for pre-contractual obligations and in downstream reporting). This will ensure a level playing field in terms of transparency for all financial services and products, and the credibility of the Swiss financial centre as a whole."

Taking the Temperature: As we have discussed previously, regulators and policymakers across the globe are paying close attention to the risk of greenwashing. Within the last few months, the UK's Financial Conduct Authority (FCA) has announced a proposal for regulating sustainability claims by investment firms and the EU has provided additional guidance for complying with its sustainability classification system, leading a number of European asset managers to reclassify the sustainability profile of investment funds

from Article 9 to the less onerous Article 8 under the EU's Sustainable Finance Disclosure Regulation (SFDR). These announcements follow draft guidelines published on November 18 by the European Securities and Markets Authority (ESMA) as part of a consultation (closing February 20, 2023) on funds' names using ESG or sustainability-related terms. We expect regulatory and civil greenwashing and greenhushing challenges to increase in 2023 notwithstanding the potential clarity that could be provided by additional guidance from government bodies such as the FCA and ESMA.