

10 lessons in sustainability regulation

Creating an effective regulatory framework will be critical to deliver Net Zero. But does that mean more – or less – regulation?

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10 lessons in sustainability regulation

From trade agreements to taxonomies, carbon adjustment mechanisms to corporate sustainability disclosure rules, a vast array of regulatory frameworks have been introduced to accelerate decarbonisation. But as [our research shows](#), the financing required to deliver Net Zero far outstrips current investment flows. And the gap is set to grow wider unless we can find the right incentives to channel more private investment towards low-carbon technologies, fast.

The quickest way to drive meaningful change across the world will entail jurisdictions adapting successful mechanisms that have been developed elsewhere – and in some cases loosening existing rules to release the shackles on markets. Opening the financial floodgates will require precision regulation, and it is therefore critical to understand what unites effective regulatory regimes and what we can learn from unsuccessful regulatory implementations to ensure the mistakes of the past are not repeated.

With this in mind, our global team have analysed a range of regulatory systems across the world to pinpoint these critical characteristics, as well as the ways businesses are building sustainability into their decision-making and governance structures. Their insights are distilled below into 10 lessons that point the way to a more effective global regulatory and compliance framework.

1 The plethora of taxonomies across the world is creating trade barriers and acting as a hindrance to international investment. Greater effort should be made to ensure harmonisation, recognising regional energy transition and security priorities.

The role of taxonomies cannot be overstated. While they remain under development in a number of jurisdictions, it's clear that the frameworks being created should, in principle, help drive investment in the right direction. Perhaps it's inevitable that taxonomies will reflect local political and energy infrastructure requirements. However, there is an urgent need for greater harmonisation to support the cross-border flow of capital into strategic low carbon industries; any failure to do so will further highlight the divide between how different states and regions are approaching the climate transition. We also shouldn't lose sight of the overriding purpose, namely, to reduce uncertainty around what can be classified as a sustainable activity and create greater market confidence.

2 Governments should learn the lessons of the past when designing support mechanisms for emerging transition technologies, recognising that different markets demand bespoke solutions. No one size fits all. We are also seeing these mechanisms increasingly intertwined with the desire to create clean energy jobs.

Driven by domestic energy, social and political considerations, a range of measures are being implemented to support transition technologies. Early mechanisms such as feed-in tariffs are still present in some jurisdictions for certain technologies. However, as low carbon systems have matured, and the cost of renewables has fallen, new support mechanisms have emerged. The impact of the US Inflation Reduction Act has been clear to see and reminds us that no one size fits all. Designing support mechanisms that reflect the realities of a particular market is critical. Governments need to ensure these measures remain relevant and fit for purpose if they're going to have the desired outcomes.

3 Businesses are facing a regulatory overload in key markets which may hamper progress in the long-term. Recognising that policy measures have a high degree of interdependency, greater focus needs to be given to how effective regulation will be in achieving the desired outcomes.

Time will tell as to which regulatory approach is best placed to drive the energy transition. For certain economies, a "top down" regulatory approach simply won't work. Market flexibility is essential. Striking the balance between robust market safeguards and allowing the market to innovate is going to be critical. We also need to be laser focused on prioritisation. There are a range of wider environmental issues (e.g. biodiversity) which need to be tackled. The question is how do we phase that approach in a manner that ensures regulation will be impactful while allowing businesses to adapt and invest in the right way? Simply imposing heavy regulation in an ill-thought-out way across multiple jurisdictions will not achieve the desired goals and will ultimately delay the recasting of the global economy.

4 The transition will drive the need for greater collaboration across industries, and more effort is needed to enhance antitrust laws and exemptions to facilitate effective cooperation.

Collaboration within an industry can only go as far as competition law will permit, and where the application of competition law is unclear, businesses will understandably tread carefully. Some antitrust authorities put significant effort into providing better clarity for businesses on how competition rules intersect with sustainability commitments, including low-carbon collaboration. But we need to see more. Competition law should not be used as an impediment – there must be recognition of the fact that the climate transition is going to require a greater degree of collaboration to drive the necessary market changes.

5 Voluntary carbon markets have a key role to play in the transition but there is an urgent need for robust market infrastructure. Frameworks for the UN-based Article 6 mechanisms must be fully baked particularly given the need for greater rigour across markets.

We have been waiting for considerable time for the build out of the infrastructure for the carbon mechanisms envisaged under Article 6 of the Paris Agreement. There is an urgent need to bring greater surety and transparency to the voluntary carbon markets. Good work is underway through a series of wider initiatives, but a UN-backed trading regime will be important. We would also want to see, outside this mechanism, greater market standardisation and consistency of rules. While the carbon markets have their critics, they have a role to play in the Net Zero transition and that role can only be fulfilled if we see an effective build out of essential market infrastructure.

6 Excessive rigidity in the debt capital markets has the potential to drive away issuers. If debt capital markets are to achieve their critical role in the transition, flexibility is needed. Let the market do its work.

Regulators must ensure issuers aren't driven away from markets by overly rigid regulatory developments while at the same time providing investors with the information they need to invest in green financial products that can be used to finance projects that will help achieve Net Zero. The current efficiency of the debt capital markets in relation to, for example, ESG bonds issued in line with the existing ICMA principles needs to be respected by providing sufficient flexibility in order to deliver that change. Ensuring guardrails are in place is welcomed, but we should let the market do its work.

7 Sustainability disclosure and reporting will continue to be fragmented across markets for some time to come. The need for greater harmonisation and more of an impact-driven approach is critical.

The calls for greater consistency in disclosure and reporting standards globally has never been louder. We are starting to see the early signs of greater harmonisation through the work of the International Sustainability Standards Board (ISSB) but we are still some way off genuine alignment. Europe's Corporate Sustainability Reporting Directive (CSRD) will further highlight global differences in approach, particularly in light of its extra-territorial effect. The need for better, more robust data on how businesses impact the environment (and vice versa) is clear. The extent of the data required and how it is presented to market participants however is a harder nut to crack. We need to simplify reporting frameworks and avoid sustainability disclosure becoming an industry in itself – while keeping a clear eye on the overall purpose of disclosure in this context.

8 Countries should avoid a regulatory “cut and paste” approach. Market infrastructure needs to be tailored and some countries will clearly benefit from a more market-driven, rather than regulation-driven, approach.

Over the past decade, Europe has demonstrated global leadership on setting environmental standards and market innovations. There are clear advantages to being a first mover but countries outside Europe attempting to simply cut and paste emerging regulations need to be wary. A thoughtful approach to market adaptation and regulatory frameworks needs to be adopted.

9 We need to see a more sophisticated deployment of international trade agreements to facilitate trade in green goods and technologies, which may include the use of tariffs to drive a shift away from certain technologies. This will not deliver an immediate solution but needs to be part of a longer-term shift.

Trade policy, has a key role to play in driving the sustainability agenda. Environmental and climate measures are being increasingly deployed in free trade agreements and this trend is set to grow. Geopolitical tensions, and a willingness to restrict market access, may, in the near term, drive the greater use of tariffs to increase domestic growth in green jobs while also acting as a protectionist measure for early phase industries. Subsidies are being deployed aggressively to support clean energy industries. However, where free trade agreements are leading to greater liberalisation, environmental measures are being included with increasing frequency. This will continue but will be a slow-burn and should be seen as part of a longer-term shift.

10 Ensuring internal governance and controls are fit for purpose in this new regulatory era is an important part of the puzzle. Businesses must be clear on their transition strategy and ensure they give sufficient resource and oversight to its implementation.

The steps any business takes to address sustainability challenges will vary according to its market and organisational structure. However, policy measures are demanding that businesses review their commercial strategies (such as through the development of transition plans) and look at regulatory change and implementation in a way never seen before in relation to environmental and climate matters. This is far from an easy task. In many markets, the shift is under way, and the plethora of new regulation demands a change in approach. The need to better integrate sustainability into day-to-day decision making is clear, and will require governance models to adapt.

1. Taxonomies – why the world needs harmonisation but not uniformity



Taxonomies – why the world needs harmonisation but not uniformity



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Taxonomies will play a critical role in channelling investment towards sustainable activities. But while alignment between frameworks is critical, a one-size-fits-all approach can never be effective

Taxonomies are frameworks that seek to define and classify sustainable investments and activities based on common criteria and standards. They are intended to help investors, financial institutions and companies align their financial and investment decisions and practices with environmental and social goals. More specifically, taxonomies can steer companies in adapting their business strategies to meet Net Zero targets and help investment funds analyse sectors based on their environmental performance.

However, the global state of taxonomies is far from ideal. Many challenges have emerged, including fragmentation and an associated lack of comparability across regions and sectors. These challenges can undermine their credibility and effectiveness and create barriers to cross-border trade. None of this would matter if taxonomies played a bit-part in sustainability regimes.

But they are increasingly at the centre of regulatory frameworks, nowhere more so than when it comes to corporate disclosure and reporting.

We are now at a point of inflexion. The number of taxonomies is proliferating, and the range of financial products presenting themselves as “green” or otherwise “sustainable” is expanding rapidly.

In this context, what would a more effective and flexible taxonomy framework look like? What features would help bridge the current deficiencies and facilitate the verification of financial products that claim to be “green” or “sustainable”?

Market fragmentation

One of the main challenges of taxonomies is the lack of global consensus and coordination on the criteria, indicators and thresholds for defining and measuring sustainability.

Many countries across Asia Pacific and Latin America have introduced green or sustainable taxonomies, or published proposals to do so. According to the Green Technical Advisory Group, there are 47 taxonomies in effect or under development. Regional initiatives exist (such as the EU Taxonomy) or are underway (such as the ASEAN Taxonomy for Sustainable Finance). These frameworks vary in scope, methodology, prescriptiveness (some are voluntary), and level of detail, reflecting different policy objectives, legal frameworks, market conditions and the need for energy security.

For example, some taxonomies aligned with the Paris Agreement prioritise climate change mitigation and adaptation. Others address wider environmental objectives such as water management, pollution and biodiversity, as is the case in Colombia. As a result, the market is disparate among key economic blocs. The Platform on Sustainable Finance has, for example, found little convergence between the EU Taxonomy and China’s Green Industry Guiding Catalogue, with the two taxonomies differing in their objectives, scope, disclosure obligations and approaches to different activities.

Taxonomy arbitrage?

Such fragmentation undermines the credibility and effectiveness of the sustainability agenda, creating as it does confusion in the market, arbitrage and regulatory gaps. For example, an activity that is considered sustainable in one jurisdiction may not be recognised in another or may be subject to different levels of scrutiny and verification, although it’s not clear how far this drives investment towards “taxonomy-lite” jurisdictions. The reality will likely be that how a particular activity is classified under a taxonomy will be one of many considerations driving investment decisions.

Hindrance to cross-border trade

A degree of diversity and adaptation is desirable and indeed necessary to account for local contexts and requirements. The difficulty is that the proliferation of divergent and inconsistent taxonomies creates significant challenges for cross-border investors and businesses, which have to navigate multiple and potentially conflicting disclosure and reporting requirements at a time when they are increasingly looking to classify their investments as “taxonomy compliant”.

This lack of harmonisation and coherence impedes efficient cross-border capital flows and creates confusion in the market, a challenge exacerbated by the uptick in tailored taxonomies that various financial institutions are creating for internal purposes.

Against this backdrop, it’s clear that the taxonomy model needs reappraising to avoid some of the emerging hindrances we are now seeing.

What a taxonomy should look like

Given the evolving market frameworks designed to drive capital towards more sustainable activities, the need for taxonomies seems unarguable. However, they should not be considered inevitable. A question remains around what the most impactful policy tools are for shifting capital in a way many policymakers want. For those jurisdictions that have chosen a regulation-lite path, there is a strong argument that no taxonomy is needed at all.

Where taxonomies are being deployed, there are some features that need to be carefully considered.

– **Flexibility and adaptability to the different contexts and needs of a jurisdiction.** Domestic and regional priorities will shape any given taxonomy, as well as its specific energy transition pathway. It would not be feasible or desirable for example to transpose a taxonomy from the EU on to jurisdictions in Asia Pacific or Latin America, where nations are at different stages of their economic development and energy transition pathways differ. For example, Colombia, one of the most nature-rich countries in the world, has focused on biodiversity in its taxonomy. More specifically, it has zeroed in on the management of soil and land by the forestry, agriculture, and livestock sectors. This reflects the fact that, when taken together, these sectors are responsible for 59% of Colombia’s greenhouse gas emissions. Ultimately, taxonomies must be suitable for each country or region. The question is how they can sit within a common framework.

– **Openness to alignment with other taxonomies.** Global taxonomies for sustainability should be consistent with, and facilitate the attainment of, the climate change mitigation and adaptation objectives established by the Paris Agreement. There may also be advantages in ensuring greater alignment in regional and national taxonomies between jurisdictions that conduct considerable cross-border trade. For instance, we expect there to be commonalities of language and base concepts between the UK’s green taxonomy, once finalised, and that of the EU. This is logical given the close trading ties between the two economies and should provide a blueprint for others to follow.

– **Living and adaptable.** A sustainable taxonomy should be a living document that accounts for and adapts to new scientific evidence, as well as policy and stakeholder feedback.

– **Global coherence.** Better international alignment around key concepts, principles and definitions would be of great benefit. We cannot expect all countries to reflect the same transition priorities in their taxonomies. We should, however, expect greater consistency between taxonomical frameworks in relation to sustainability reporting standards.

Sustainability taxonomies can play an important role in scaling up transition finance. While they cannot act as a safe harbour against greenwashing claims, the ability of financial institutions in particular to demonstrate that their use of investment labels is linked to a robust set of criteria and methodologies will be critical. Corporates will also increasingly need to report their activities as being taxonomy aligned. Given their role, much greater focus therefore needs to be given internationally to minimising taxonomy fragmentation. We shouldn’t also assume that taxonomies are the right model for every economy. They are not an end in themselves and their fundamental purpose should be paramount – to reduce uncertainty around what are classified as sustainable activities, to provide greater confidence in the market, and to facilitate the Net Zero transition.

2. State support mechanisms



State support mechanisms – learning from the past to accelerate the future



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Government backing is critical to tilt markets in favour of green energy. But to incentivise the innovation required, we have to reflect on past failures

In his 2021 book *How to Avoid a Climate Disaster*, Bill Gates coined the term “green premium” to explain the economics of decarbonization. Gates used the concept to articulate why green energy is more expensive than grey – because most new low-carbon innovations have not yet benefited from the same economies of scale built up by carbon-intensive supply chains over decades, and because the price of high-carbon power usually doesn’t factor in the environmental cost of generating it.

Gates goes on to highlight that government support measures are critical to reduce and progressively negate the green premium. Market forces will eventually incentivise green over grey, but without state intervention the transition to Net Zero will be too slow to avoid the worst effects of climate change, and too disorderly to manage the impact on economies.

As much as the transition is about economics, it is also to a large extent a legal issue. In addition to risk allocation and legal design, there is a pressing need for stakeholders (primarily, investors) to have clear visibility of the regulatory landscape over long periods of time.

The last two decades have brought good news and important lessons. The growth of renewables (for instance, offshore wind in northern Europe) shows how effective state support can be. The accumulated experience also shows how the tools need to evolve over time, and the pitfalls governments need to avoid.

A brief history of support measures

Early mechanisms included feed-in tariffs schemes (which are still in use in some jurisdictions and for certain technologies), whereby a project owner sells renewable energy to the state for an agreed price, ensuring the bankability required to build the necessary infrastructure or assets. Under these tools, market price risks are largely borne by the public sector and some cases have resulted in significant costs to the public finances.

Over the past decade, as technologies and supply chains have matured and the price of renewables has fallen, new risk-sharing mechanisms have emerged. Contracts for difference (CFDs) were designed in the UK and have turned the country into an offshore wind superpower.

CFDs also involve the project owner and government agreeing a price for electricity, but rather than the state buying the power directly, it’s sold on the market with the government subsidising any shortfall between the contracted price (the “strike” price) and what the market will pay.

This increased exposure to market risk has led project owners to enter into power purchase agreements (PPAs), typically with “aggregators” (entities in charge of bundling capacities and selling to wholesale buyers such as suppliers and traders) but also increasingly with large corporations looking to decarbonise their businesses (e.g., data centres operators). The rise of corporate PPAs (CPPAs) is a sign of maturity, although they require tailored risk allocations.

Overall, there is debate over whether the public money channelled in subsidies to renewables has always been well spent. There is little doubt however that public investment has been instrumental in driving down costs, enabling rapid development across the globe – most impressively in China and some parts of Europe.

Past policy failures reveal important lessons

Understanding the dynamics of state support schemes – what’s worked and what hasn’t – is essential to accelerate the transition to Net Zero. Decarbonizing the global economy will require a vast array of new technologies beyond “classic” renewables (i.e. wind and solar), from sustainable aviation fuels to green hydrogen and its derivatives (e.g., green methanol). These will need to be delivered at scale with a decreasing “green premium” over time. To do this quickly, stakeholders must learn from the past.

On the European side, Spain provides an example of what happens when incentives are poorly designed. In 2007 the Spanish government introduced generous feed-in tariffs to increase the country’s solar generation capacity, setting a fixed price for electricity from solar farms connected to the grid within a certain timeframe that was several times higher than the market rate.

Spain was immediately flooded with supply, resulting in the government’s 2010 target for additional capacity being met within months. However, there was no provision in the legislation to reduce the tariffs in line with market developments, and when the 2008 financial crisis hit there was public outcry over the spiralling cost of the policy. The government eventually lowered the incentives by 30%, and then introduced legislation in 2013 which applied further retroactive cuts. The U-turn has sparked a rash of arbitration claims as investors scramble to recover their losses; at the end of 2022, Spain was still facing at least 51 claims worth more than EUR8 billion.

In the U.S., feed-in tariffs for solar energy were also introduced in the late 1990s and early 2000s, and are only one example of pricing schemes that have failed to adjust to changing market conditions over time.

California, for example, implemented net metering rules for residential solar energy use in 1995, allowing homeowners to install solar panels and sell excess electricity back to the utility company at the retail rate.

At the end of 2022, however, a unanimous vote by the California Public Utilities Commission resulted in an overhaul of the regulations that reduced payments to homeowners by 75%. The changes sparked intense debate, with government officials maintaining that price cuts were necessary to reflect evolving consumer habits; heavy residential power use has shifted to evenings yet solar energy is abundant during the day. The new rules accordingly include state funding for paired solar-battery storage systems, as well as incentive payments for low-income households.

Policy failures can also stem from setting the bar for state support too low. Recently the UK government found this out to its cost when its 2023 offshore wind auction failed to elicit a single bid. The auction would have paid producers £44 per megawatt hour for their electricity – slightly higher than the previous auction in 2022 (when contracts were selling for £37.50 per MWh) but well below 2015, when producers were guaranteed £155 per MWh. Ministers had been told that the impact of inflation and significantly higher borrowing costs made £44 unrealistic, but failed to heed the warning.

Governments must stand strong in the face of opposition

Not only must governments set the right sort of policies to achieve Net Zero, they must also stand by them in the face of opposition and react quickly in case of destabilisation.

In 2012, a well-known French pressure group *Vent de Colère* (wind of wrath) sued the government over its feed-in tariffs for wind producers, arguing that they should be barred under EU state aid laws. For four years the case progressed all the way to the European Court of Justice, with the policy eventually annulled and replaced (for new projects) with a new CFD scheme. During this period the government was equivocal in its backing for the industry and provided little visibility on what would happen if the challenge had a negative impact on tariffs. This had a chilling effect on investment and significantly slowed down the rollout of renewables in France.

Had the state sent a stronger signal that wind power had its support despite the challenge, this could have been largely averted. Navigating the complex state aid rules in Europe remains a challenge for all member states and businesses alike, but is essential to setting a stable, efficient support scheme.

Businesses are taking the lead to navigate regulatory fragmentation

Of course governments do not always lead business. Companies are also working ahead of policy by collaborating to build new technologies and accelerate the development of supply chains so they can achieve economies of scale. They are also joining forces to create the certainty they need to pursue more ambitious Net Zero investments and navigate complex and sometimes contradictory regulatory regimes.

One example of this in action is in the U.S. auto sector. The U.S. regulatory framework for electric vehicles is fragmented, with the market influenced by everything from the Inflation Reduction Act to the Environmental Protection Agency, [federal grant schemes](#) and state and municipal rules.

Amid a partisan political environment in which climate policy is a battleground issue, car manufacturers are taking the initiative in a bid to reduce political risk. Several leading automakers (including BMW, Ford, Honda and Volkswagen) have agreed bilateral framework deals with the Californian government that incentivize faster emissions reductions than current laws require. The reason this is important is because California's EV laws are adopted in a further 13 states, meaning these support measures now extend across more than a third of the U.S.

Another example is the burgeoning clean hydrogen production sector. Businesses were quick to identify the need to establish clear rules to certify that the hydrogen produced complies with low-carbon standards and regulations.

For instance, CertifHy, a public-private partnership, started working as early as 2020 to develop certification processes open to all players active in Europe. They are now being integrated as a certified voluntary scheme into the recently stabilised set of rules on so-called “renewable fuels of non-biological origin” (RFNBO). This approach is a clear accelerator for the development of the sector and could be used for other types of transition assets, including sustainable aviation fuels.

Finally, companies are also adapting their purpose to accelerate their transformation strategies.

In the U.S., for years corporate law has been cited as a barrier to decarbonization because of the widely held view that fiduciaries must give primacy to shareholder returns over broader societal objectives. However, there is now a growing body of case law in which values-first decision-making has been protected under states' business judgement rules.

For example, Leo Strine, former Chief Justice and Chancellor of the State of Delaware – as well as many other experts – have argued that the majority of states' flexible corporate chartering statutes give companies a generally free rein to pursue any new line of business as long as it's legitimate and above board. This broad freedom is possible because the principle is underpinned by statutory requirements for lawfulness in states' corporate codes, and these codes explicitly allow directors to consider interests other than those of stockholders when making corporate decisions.

Similarly, in August 2019 the Business Roundtable, a nonprofit organization [whose members are CEOs of some of the biggest U.S. companies](#), updated its statement on the purpose of a corporation to include “commitment[s] to all of our stakeholders”: customers, employees, suppliers, communities and shareholders.

A similar trend can be seen in Europe. For instance, in France, the government paved the way for companies to insert in their statutes a fundamental purpose (*raison d'être*) which goes beyond financial success, through the 2019 “PACTE” law. Many businesses have answered that call, contributing to an acceleration of their transition to sustainability with increased appetite and investment towards low-carbon assets and energy.

Proposed EU market reforms reflect past policy failures

Looking ahead, there are signs that lessons have been learnt from two decades of low carbon policy development.

First, we are seeing more tailored, stable support schemes. Following Spain's ill-fated solar tariffs, Europe's proposed electricity market reforms are based on two-way CFDs that provide the flexibility to handle energy price shocks. Under these bilateral structures, producers still receive a guaranteed strike price, but where they sell their electricity for more on the market (as has been the case at points during the war in Ukraine), the excess flows back to the state without limitations. Setting clear rules, with stability and visibility over time, will be crucial for guaranteeing the credibility of this system which is likely to be tested in the coming years as energy systems transition to low carbon, high renewables and high storage capacities.

As some technologies continue to mature, public support schemes must evolve in parallel. The more rapid development of corporate PPAs is now an official goal of the ongoing electricity market design reform being debated in Brussels.

But it is recognised that market players (developers and customers) may not yet bear all the risks. That is why the use of public guarantees for these schemes is being considered if a project fails to hit certain financial goals over a period of time.

Second, the support required goes beyond financial considerations. Effective permitting is just as crucial. The rollout of renewables has been plagued in many jurisdictions by slow, uncertain permitting regimes, with some countries taking many years to grant the necessary approvals. The EU has been moving since 2022 to require member states to deliver permits within a set deadline (typically, one year) – although it remains to be seen whether in practice this will be possible, given the lack of resources some authorities face to process applications.

Another key concern is legal challenges against projects and their permits. Investors typically refuse to fund projects where challenges are on-going or still possible. Some countries have moved to limit the right for third parties to challenge projects, for instance by setting a limited duration for proceedings or referring challenges directly to appeal or even supreme courts. Here again, finding the right balance will be critical.

Looking ahead

Finally, as well as building flexibility into regulations, policymakers must also reflect on the importance of engagement with industry to create effective regimes and consider the optimal duration of support mechanisms to provide businesses with certainty. The U.S. Inflation Reduction Act has won praise in this regard, with many of its credits extending for more than a decade.

This is where case law developments such as those in the U.S. offer further hope. An increasing slate of decisions in favour of values-based decision-making should create momentum for more ambitious decarbonization strategies among purpose-driven boards. Ultimately, it will require a combination of government and private sector action to provide the coordination and clarity needed to advance the Net Zero transition.



3. Is more regulation the best route to deliver Net Zero?



Is more regulation the best route to deliver Net Zero?



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How to accelerate the transition to a sustainable economy is a hot regulatory topic for most major economies around the world – and is set to continue ascending the agenda in the years to come. As sustainability-related regulations proliferate, the legal risks and obligations on global businesses grow. We reflect on the implications of divergent regulatory regimes, and consider whether a regulation-heavy approach is likely to deliver its intended results

It is perhaps no surprise that there is significant variation in the pace, scope and stringency of sustainability-related regulation across the globe. Regulatory design and implementation are driven by a broad range of jurisdiction-specific aims, including energy security, the competitiveness of domestic industries, jobs, consumer and investor protection, and political philosophies and compromises.

This fragmented regulatory backdrop presents a major compliance challenge for global businesses. Existing regulations already diverge on multiple fronts, including in relation to their level of prescriptiveness, extraterritorial reach, industry coverage, approaches to materiality (i.e. whether disclosures should focus on impacts on the company's financial position and prospects, or also cover the company's impacts on sustainability), the extent of applicability to downstream and upstream operations, and the degree to which non-compliance is monitored or subject to sanction.

Globally, the overall momentum for regulatory change is set to grow as new rules are made, implemented and applied. The regulatory landscape will continue to evolve as market consultations are held, existing regulations are fine-tuned to address teething issues, questions of interpretation arise, and obligations extend in scope, moving from a voluntary to a mandatory footing.

Regulatory activity is likely to be high, for instance, in relation to sustainability reporting, with many regulators considering how, and in what policy areas beyond annual reporting, they might implement or align with the global baseline standards created by the International Sustainability Standards Board (ISSB). Inspired by the U.S. Inflation Reduction Act (IRA), there is also a growing willingness across the world to incorporate incentives-based measures into Net Zero transition journeys. Legislators should look to avoid a cut-and-paste approach to accommodate local nuances, while keeping an eye on international developments and impact assessments.

The EU: poster child for a regulation-heavy approach

So far, the EU has been the poster child for a regulation-heavy approach to tackling the Net Zero challenge. The European Commission has made significant progress in driving forward its dedicated programme to revise, update and introduce regulations (including a wide range of product- and sector-specific laws) at breakneck speed. These include regulations spanning sustainability reporting, labelling and disclosure; supply chain due diligence; sustainable finance and greenwashing; a carbon border adjustment mechanism (CBAM); and energy taxation, to name just a few.

However, there have been calls in Europe and elsewhere for a “regulatory break”. Politicians are under pressure to be seen as striking the right balance between looking after the socioeconomic prosperity of their electorate and meeting climate targets.

To varying extents, businesses are struggling to keep up with the whirlwind of regulatory changes, particularly those driven by the EU. As new measures are devised, shortcomings and impacts are identified and attempts are made to refine them, the EU's legislative train may take on a different pace. It is notable that, at the time of writing, the text of the proposed EU Corporate Sustainability Due Diligence Directive has not received the necessary final legislative approvals and it is looking increasingly unlikely that the text will be adopted, in this legislative term at least.

The UK: on a path of towards tighter rules

Across the Channel, there are clear signs that the UK is traveling down the path of increasing regulation. However, wary of over-regulation, the UK government is treading a delicate path. It is not, for instance, planning to introduce extensive mandatory due diligence laws on human rights and environmental impacts equivalent to those in Germany and France (and potentially at EU level). There were also moves in 2023 by the UK government to water down certain energy- and transport-related policies that were designed to contribute to the Net Zero transition.

That said, there are a several regulatory reforms in the pipeline. For example, the UK Sustainability Disclosure Standards are expected to be created based on the ISSB standards by July 2024, and the Financial Conduct Authority's anti-greenwashing rule and sustainability labelling rules are due to apply from May and July 2024. In addition, the UK government is due to consult and/or legislate on regulatory changes across a range of sustainability related policy areas in 2024, including the UK green taxonomy, transition plans and transition finance, reporting requirements, the design and delivery of a UK CBAM, changes to the UK Emissions Trading Scheme, regulation of ESG ratings providers, and rules to address deforestation risks in supply chains.

Several of these initiatives were originally due to take place in 2023, and their delay may be indicative of attempts to take a more measured approach to rolling out regulatory reforms. This may provide businesses with more breathing room and enable a greater focus on complying with their immediate obligations..

Asia-Pacific: a varied climate change regulatory landscape

The regulatory landscape in Asia-Pacific is varied, with a strong focus to date on climate change. Common themes and approaches are evident across the region, with national nuances linked to factors such as the status of national economic development and regulators' focus on financial risk management. The constantly evolving regulatory landscape increasingly recognises standards and requirements from elsewhere – including the EU's sustainable finance rules and regulators' use of the Taskforce on Climate-Related Financial Disclosures (TCFD) framework. Notably, Hong Kong's proposed Green Classification Framework, while largely referencing the Common Ground Taxonomy, also aligns with classification systems such as the ASEAN Taxonomy (itself closely linked to individual taxonomies in South-east Asia, such as those in Malaysia and Singapore), with the hope that this will facilitate interoperability in the region. Similarly, in future we expect reporting frameworks based on the ISSB standards (and indeed these have already been proposed for listed companies in Hong Kong and Singapore) and a growing focus on regulatory requirements and guidance on transition planning.

The U.S.: pulling regulatory levers amid a growing anti-ESG wave

Not all jurisdictions are equally focused on using regulatory levers to achieve their Net Zero goals. The U.S. approach is heavily incentives based, and is best seen in the Inflation Reduction Act (IRA) which is a flagship package of targeted measures to drive investment in selected green technologies and boost domestic supply chains.

The IRA is a great example of smart regulatory intervention aimed at rapidly slashing emissions.

The U.S. climate regulatory policy environment continues to be punctuated by anti-ESG sentiments. Notably, the U.S. Securities and Exchange Commission is expected to face legal challenges over its upcoming climate disclosure rule although there have been delays in finalising its underlying reporting requirements, including the extent to which scope 3 emissions reporting will be needed. In the meantime, new legislation in California will require extensive disclosures of climate-related risks and scope 1, 2 and 3 emissions. The U.S. is therefore adding to the growing global tapestry of climate-related disclosure rules that businesses (and, indirectly, their supply chains) have to contend with.

The Middle East: momentum building for reforms

In the Middle East there are several ESG reporting guidelines and sustainability reporting requirements. For instance, we have recently seen developments in the UAE's sustainable finance regulatory framework, while other jurisdictions in the region are also starting to gear up their reform programmes. However, the momentum for sustainability regulatory reforms appears to be slow in certain jurisdictions, which have largely left it to the private sector to take voluntary steps such as devising sustainability policies and disclosing sustainability-related information. In 2024, we expect that more regulatory measures or guidelines will likely be developed across the region given the renewed focus on sustainability as a result of the recent COP28 in Dubai.

Extra-territorial reverberations in regulatory and market practices

A key question for business as regulations develop globally is the extent of their extra-territorial effect. Extra-territoriality is often intended to level the playing field amid an uneven regulatory landscape, to mitigate problems such as carbon leakage and loss of competitiveness. The desire to extend regulatory reach beyond jurisdictional boundaries reflects a growing assertiveness by countries seeking to raise market standards irrespective of host jurisdiction.

In particular, certain in-force and proposed EU laws will implicate non-EU businesses and may accelerate the adoption of sustainable business practices beyond European shores.

In the interests of legal certainty, there are good reasons for other jurisdictions to take a “watch and wait” approach while first-mover jurisdictions deal with regulatory teething problems.

Notably, the EU’s experience offers lessons for regulators elsewhere, and identifies challenges that businesses can pre-empt in other jurisdictions. For example, we see compliance challenges and legal risks arising from the misalignment between investor and corporate disclosure rules, and from ambiguities and inconsistencies in key concepts under the EU sustainable finance framework.

However, the verdict is still out on whether the push to achieve Net Zero is better served by pressing ahead with ambitious legislative reforms despite shortcomings in regulations themselves or via a slower but more measured approach to regulatory change. This is a familiar conundrum not just at national level, but also at global level. For example, launching the ISSB’s first two sustainability reporting standards on a single materiality approach may achieve a more widespread uptake of the baseline standard, but taking the time to build consensus for double materiality may ultimately spur more decisive action in favour of sustainability goals.

What is clear is that public sentiment on the environment has shifted in many parts of the world, and businesses must be agile to make decisive changes to further Net Zero goals.

The emergence of “gold standards” – a race to the top?

Across the spectrum of sustainability regulation there are measures that aspire to be “gold standards” (or that may in the future be regarded as such through widespread adoption over time). These include the European Sustainability Reporting Standards (required under the EU Corporate Sustainability Reporting Directive), the EU Green Bond label, the UK transition plan disclosure framework, the Singapore-Asia Taxonomy for Sustainable Finance, and the upcoming UK green taxonomy. There remains, however, a question of whether market participants will pitch themselves above a common baseline, or unite around more exacting frameworks.



It is possible for a market-driven, high standard of regulatory compliance to emerge as industry best practice. This may happen when businesses that are bound to comply with more stringent standards in certain jurisdictions choose to adhere to them everywhere they operate. Widespread observance of higher standards of regulation may also emerge as more businesses require parties in their global value chains to meet the same requirements, in favour of standardising contractual terms, compliance procedures and data-gathering processes across jurisdictions.

Regulatory fragmentation remains a challenge, and interoperability remains a pursuit

Regulatory fragmentation risks jeopardising the goal of reallocating capital in a way that genuinely achieves decarbonisation. This risk may manifest itself in a variety of ways. First, when businesses reorganise their global footprints, adapt their supply chains and make investment decisions to pivot to less stringently regulated jurisdictions, they lose the regulatory constraints that would have driven them to make meaningful changes to their business practices.

The counter to this type of behaviour comes via measures designed to address carbon leakage.

Second, and importantly, inconsistencies across regulations may create a conducive environment for inadvertent or opportunistic greenwashing, thereby sending ambiguous or incorrect signals as to where capital should flow for Net Zero purposes. Notably, there could be conflicting claims of taxonomy eligibility or alignment, given the proliferation of taxonomies with jurisdiction-specific features (e.g. varying definitions of environmentally sustainable activities).

To accelerate the transition, jurisdictions should avoid smothering market innovation with hasty over-regulation. Irrespective of how far-advanced each jurisdiction is in devising its transition strategy, it remains pertinent to consider what effective regulation means and how else to drive Net Zero-aligned market practices. Greater focus should be placed on incentivising the right levels of investment and disclosure, while factoring in international interoperability from the outset.

There is a strong case for regulators to strive towards a high level of international alignment, but there are also undeniable differences among jurisdictions in terms of economic position, investment needs, and indeed the maturity of financial markets and regulatory regimes. In the pursuit of interoperability, genuine jurisdiction-specific needs should not be neglected. Different countries will opt for different strategies, as there is no single route to driving the transition. Time will tell which strategy is the most effective.

4. Decarbonization can only be achieved by businesses working together



Decarbonization can only be achieved by businesses working together. So is antitrust law a barrier?



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We need legal certainty around how antitrust regulators will cooperate with each other – and with industry – to assess collaborations and joint industry standards on low-carbon solutions

Collaboration within an industry can only go as far as competition law will permit. In practice, where the application of competition law is unclear, collaboration will often only go as far as is comfortable for the most cautious industry player involved. Where regulators in different jurisdictions apply competition law differently, or have different sustainability policies, the potential for collaboration can be reduced further because businesses seeking a global solution will need to ensure their collaboration meets the strictest standards that any relevant regulator may apply.

Some antitrust authorities have put a lot of effort into providing clarity for business on how competition rules apply to sustainability agreements, including low-carbon collaboration. The Netherlands Authority for Consumers and Markets (ACM), UK Competition and Markets Authority (CMA), European Commission, the Competition and Consumer Commission of Singapore (CCCS) and the Japan Fair Trade Commission (JFTC) have, for example, each published detailed guidance on this topic.

Crucially, they have each also offered to provide informal guidance to businesses that are unsure about how competition law will be applied to the initiatives they are considering, which allows authorities to respond flexibly to novel cases that their guidance could not have anticipated.

The ACM was the first to offer advice and, less than three years later, has received more than 20 requests. Businesses may have been particularly encouraged by the ACM's commitment not to impose fines for any that followed its guidance in good faith. The CMA, CCCS and JFTC have made similar commitments.

Agencies offer guidance – but take divergent approaches

While businesses will undoubtedly appreciate the clarity and comfort that some regulators are offering, *effective* Net Zero collaboration often spans multiple jurisdictions. Even the regulators offering guidance and advice have taken different approaches to key issues. The CMA and ACM have said, for example, that the society-wide benefits of some low-carbon collaborations should be able to outweigh their possible harm to competition, implying this might be possible even where the net impact on certain groups of customers who are affected by the harm to competition is in fact *negative*.

The European Commission, by contrast, recently reaffirmed its view that the proper approach is to include, in the “weighing” exercise to apply a competition law exemption, only benefits that are felt by consumers who are harmed by a restriction of competition, so that the net impact on those consumers is positive. This difference of opinion has already put the ACM in a difficult position – it was forced to withdraw its more permissive advice on how to *interpret* the law on exemption and instead issue a “Policy Rule” as a guide to how it will *enforce* the law.

In jurisdictions where formal guidance has not been issued, companies must rely on broader policy statements from regulators, some of whom have expressed scepticism about the role that environmental sustainability considerations can play in a competition assessment (echoing sentiments from Lina Khan of the US Federal Trade Commission, who noted that there is “no such thing” as an “ESG exemption”). Faced with these mixed messages, businesses too often find themselves reducing the scope of their ambition for industry-wide collaboration.

While global alignment is unrealistic, some harmonisation is required

It will not be realistic for competition authorities globally to reach alignment on the degree of collaboration they will permit on a topic as politically charged as climate change when each exists in (sometimes radically) different legal frameworks and political environments.

However, there is still significant distance that regulators should travel together to ensure that, at minimum, businesses are not forced to abandon beneficial sustainability projects because the law in one or some jurisdictions is unclear to them.

This should include some degree of information sharing about “novel” forms of collaboration that authorities investigate or advise on, to allow each to keep up with the pace of innovation in this field when investigating, or issuing guidance or advice.

It could also include the pooling of resources to consider specific sustainability and competition law issues together. The Netherlands ACM and Greek competition authority have, for example, previously collaborated on a technical report exploring economic tools to measure sustainability benefits as part of a competition law analysis.

Ideally, it will also include frequent dialogue about the challenges industries are facing and how competition law can work to preserve competition and protect consumers without unduly obstructing the changes needed to tackle climate change.



5. Credibility is required to scale the carbon markets



Credibility is required to scale the carbon markets



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With the Intergovernmental Panel on Climate Change (IPCC) concluding that it will be difficult (and in some cases impossible) to reduce emissions to zero in certain sectors, several hundred million tonnes of CO₂ will need to be removed from the atmosphere to decarbonize the global economy¹. The voluntary carbon markets are expected to play a critical role in this regard over the next decade and beyond.

The global value of the voluntary carbon markets quadrupled between 2020 and 2021 to USD2 billion, and is expected to grow further as more businesses pledge to operate on a “Net Zero” basis²³.

But how fast, and how far, the markets develop will be determined, in large part, by their integrity. The focus on precisely what is being bought and sold, and how it can be used, will intensify.

Credibility is already a key concern. In the past year we’ve seen public critiques of both the markets as a whole and the veracity of particular credits – and the associated quality of the emissions reductions and removals – traded on them. Where these accusations arise, greenwashing claims and reputational damage can follow.

Carbon markets will be vital to deliver Net Zero, but to be effective they must be trustworthy. Here we explore efforts to build assurance – and suggest what the ideal framework might look like

There are multiple platforms that issue voluntary carbon credits, and an even greater number of underlying methodologies and standards. As a result it can be difficult for investors to assess which are robust and can appropriately be used to offset a company’s greenhouse gas (GHG) emissions.

¹ IPCC 6th Assessment Report (https://report.ipcc.ch/ar6/wg3/IPCC_AR6_WGIII_Full_Report.pdf#page=48).

² Ecosystem Marketplace, “The State of the Voluntary Carbon Markets 2022 Q3 Briefing,” August 3, 2022.

³ McKinsey, “A blueprint for scaling voluntary carbon markets to meet the climate challenge”, January 29, 2021.

There are several important initiatives under way that are designed to address this issue, including the roll-out of the Core Carbon Principles (CCPs) published by the Integrity Council for the Voluntary Carbon Market (ICVCM), and the European Commission’s proposal to establish an EU-wide voluntary framework for certifying high-quality carbon removals. Here we assess both schemes and pinpoint the elements we believe can support the transition to Net Zero.

What are the objectives of the CCPs and the proposed European regulation?

The ICVCM – an independent body that sets and enforces global standards for the voluntary carbon markets – adopted the CCPs in March 2023. They have a series of objectives tied to governance, emissions impact and sustainable development, but which are not solely about climate change. These were supplemented by an assessment framework which was released in July 2023.

A key objective of the CCPs and the associated framework is to provide the voluntary carbon markets with additional credibility, in turn allowing for greater confidence in carbon offsetting. It remains to be seen, however, whether they will be widely used by participants within the voluntary carbon markets. Initial indications are promising, however, with Verra’s Verified Carbon Standard, the Gold Standard and the American Carbon Registry (being three of the largest standards) all set to take part.

The European Commission’s proposed regulation to establish an EU-wide voluntary framework for certifying high-quality carbon removals was published in November 2022.⁴⁵ The Proposal is in response to three problems the Commission believes are inhibiting the development of carbon removals in the EU: (i) the difficulty in assessing and comparing the quality of those removals; (ii) a lack of trust in (existing) carbon removal certificates (i.e. voluntary carbon credits); and (iii) barriers faced by providers of carbon removals to access finance.

The Proposal seeks to address these issues through its ‘QU.A.L.I.TY’ criteria, which cover QUantification, Additionality, Long-term storage and sustainabiLITY. Owners with projects that pass will be able to apply to a certification scheme which records carbon removal units in certain public registries. The certificates would be subject to verification, and once issued could be sold, for example for offsetting purposes. The methodologies underpinning them will be given the force of law through the adoption of delegated acts.

How do the CCPs work, and what are their main challenges?

The regime behind the CCPs is, at its heart, a labelling framework. Where the requisite conditions are met, a voluntary carbon credit (from any standard) can be CCP-labelled. It is intended that CCP-labelled credits will help buyers more easily identify and price high-integrity carbon credits, no matter who has issued them or where they were generated. In turn, this is intended to help overcome market fragmentation, and give buyers more confidence in what they are buying.

To obtain the CCP label, a carbon credit must meet the CCPs at two levels: the program level (eg the Gold Standard, which announced its application on 12 October 2023⁶; or Verra’s Verified Carbon Standard, which applied on 21 November 2023⁷), and the category level (e.g., “direct air capture” or “efficient cookstoves”).⁸ More explicitly, specific methodologies from the programs are tested against the latter (e.g., the Gold Standard’s “Simplified Methodology for Clean and Efficient Cookstoves” is being CCP-assessed via the “efficient cookstoves” category etc.).

⁴ Ecosystem Marketplace. “The State of the Voluntary Carbon Markets 2022 Q3 Briefing.” August 3, 2022.

⁵ This is a legally binding commitment set out in the European Climate Law which requires balanced emissions and removals of GHGs by 2050 at the latest and with the aim to deliver negative emissions thereafter.

⁶ <https://www.goldstandard.org/blog-item/gold-standard-submits-programme-level-assessment-icvcm-champions-alignment-paris-agreement>

⁷ <https://verra.org/statement-verra-submission-icvcm/>

⁸ <https://icvcm.org/category-assessment-status/>

By early February 2024, six programs had sought assessment, although none had been fully assessed; while checks on the Verified Carbon Standard (being the standard which produces the largest number of voluntary credits by volume) had yet to start. At the end of January 2024, the ICVCM announced that it was assessing more than 100 methodologies with the aim of announcing the first decisions by the end of March 2024.

Key market players have also questioned whether a one-size-fits-all approach is feasible or even desirable in such a versatile market.⁹ It is noted, for example, that some projects that are otherwise promising from a GHG standpoint may fall short of the CCP certification standard for non GHG-related reasons.

The main questions on the project (and supply) side revolve around whether a specific project would be compatible with the CCP's requirements, whether any extra work would be needed to obtain the label, and whether this would justify the benefit. This will clearly be highly fact-dependent, but where a project is clearly eligible, the key issue is whether adhering to the CCPs will help it generate credits by improving either the price and/or marketability of those credits, and if so, to what extent.

From the investor (and purchaser) side, the principal consideration is whether the benefits of the CCP label justify paying a premium. This could be, for instance, because less time is needed to diligence the underlying project, or because the label gives additional comfort around perceived quality, reducing reputational risk. Linked to this, it will be interesting to see whether CCP-labelled credits are able to remain “scandal free” in the medium and long term, particularly as scrutiny is expected to be high in the initial years.

Even if the CCPs gain traction, we don't expect the initiative to declutter the fragmented nature of these markets, at least in the near future.

We anticipate that many of the much smaller standards will continue to operate, although some may become further marginalised, particularly if they do not have the resources to participate (i.e., to complete the initial program-level assessment as required by the ICVCM's regime).

Along similar lines, we see a risk that, if the CCP label becomes very successful, it could ultimately create a one-size-fits-all approach that is able to directly set the scope and rules of the market. This, in turn, may stifle innovation and, in some cases, potentially limit the flow of carbon finance to projects that do have merit, but don't fall squarely within the CCPs' requirements.

What about Europe's proposed certification framework?

The European Commission's proposed criteria are only set to apply to carbon removal activities that take place in the EU, which hasn't yet established itself as a hotbed for removal-based projects in the mainstream voluntary markets. As a result, even if the Proposal is successful, it's likely to cover only a small proportion of the credits traded on the carbon markets.

That said, it could be an important step. Firstly, we anticipate that any methodologies developed by the Commission are likely to be considered robust, which in turn will help raise the bar on what constitutes a “good” removal credit in similar ways to the CCPs.

Secondly, the mere fact that the Commission itself has developed the methodologies and the context in which the certificates will be issued should give material comfort to more conservative investors, for example around greenwashing risks. This could, therefore, reasonably be expected to bring new participants into the voluntary markets.

Thirdly, the Proposal contemplates a regular review by the Commission of the regulation as implemented and by reference to wider developments, such as the status of the Paris Agreement. Over time, we anticipate this could lead to the regime being extended in the same way as ESG-related corporate reporting has been gradually developed in recent years.

Fourthly, the certificates could be used for purposes beyond offsetting. As a result we expect links could be established between the scheme and wider results-based financing initiatives created by other EU policy instruments, such as the Common Agricultural Policy, as well as state aid schemes run by individual member states.

Some groups have already called for the Proposal to be adapted to prohibit the certificates being used for ordinary offsetting purposes in the voluntary carbon markets.¹⁰ They argue, for example, that: (i) demands for removals must not come from actors that still have scope to reduce their own emissions but haven't yet done so; and (ii) companies shouldn't be allowed to use removal offsets as a means of avoiding carbon pricing or emissions cuts in their own value chains. It remains to be seen what weight the EU's legislators will give to these sorts of arguments.

Finally, if the Proposal is successfully developed, we anticipate that it could influence similar “sovereign” constructs elsewhere. There is a wider trend for states to seek to control more closely what happens in the voluntary carbon markets vis-à-vis activities undertaken within their jurisdiction. (At the time of writing the EU's institutions (the European Commission, the European Council, and the European Parliament) were looking to finalise negotiations.)

⁹ <https://verra.org/icvcm-course-correction-needed/>

¹⁰ See, for example, the open letter from, amongst others, Carbon Market Watch to the European Commission dated November 4, 2022 here: <https://carbonmarketwatch.org/wp-content/uploads/2022/11/Open-letter-NGOs-to-Cabinets-on-CRCF-priorities.pdf>

What would the ideal carbon markets framework look like?

Instilling credibility into the voluntary carbon markets is vital for their success. Buyers of voluntary carbon credits want to know that doing so won't expose them to reputational risks or accusations of greenwashing. The widespread implementation of (and adherence to) a robust set of integrity standards should bolster market confidence and allow purchasers to make informed commercial comparisons between credits across what is currently a fragmented and diverse global market. Increased direct involvement of states and supranational bodies such as the EU will help increase confidence, too. Both the CCPs and the European Proposal (if implemented) will assist with credibility, but each also has its limitations.

The CCPs, for instance, while setting high standards, remain an independently managed voluntary initiative. Their success will be determined by uptake and how the markets ultimately view their labels and the quality of the underlying credits.

The EU Proposal would be voluntary and limited to removal-type activities from EU-based projects only, materially limiting its scope.

The ideal, of course, would be to combine the best elements of both. This would see legislators create robust, publicly managed frameworks through which high-quality voluntary carbon credits can be issued, sold and used, and which sit alongside the existing frameworks offered by the private sector. This is, of course, the hope for the new Article 6.4 mechanism being developed by the United Nations. Over time, the successful deployment of such structures should build credibility in and of itself.

It remains to be seen, however, how successful (and ambitious) the Article 6.4 framework will be, and there are concerns with regard to the proposed integrity and quality of the A6.4 credits that are expected to arise from it. These concerns were, of course, at the heart of a lack of progress on Article 6.4 at COP28, as UN members disagreed on precisely this point.

Prolonged deadlock on this issue at UN level will, though, only increase the importance for initiatives such as the CCPs and the EU Proposal to plug the gap.

In the meantime, the EU and other key players have shown no real appetite to become further directly involved with the management and operation of the voluntary markets. Their position, for now, is primarily focused on softer approaches linked to both corporate disclosures and the regulation of making offsetting claims. Whether such plans, when coupled with initiatives like the CCPs and the EU Proposal, will bring sufficient credibility to the voluntary markets in and of themselves is uncertain. They are, however, steps in the right direction.



6. To deliver change, regulation must respect the efficiency of the debt capital markets



To deliver change, regulation must respect the efficiency of the debt capital markets



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Excessive rigidity has the potential to drive away issuers. Authorities focused on delivering Net Zero must therefore design rules with this in mind

When the European Council adopted the EU Green Bond Regulation on 24 October 2023, the press release stated: “The new standard will foster consistency and comparability in the green bond market, benefitting both issuers and investors of green bonds. Issuers will be able to demonstrate that they are funding legitimate green projects aligned with the EU taxonomy.”

The aim of regulation in this area is to promote funding for genuine sustainable investment, and finance the move to deliver Net Zero. Investors are demanding more information to provide them with assurance that their investments are contributing to this change, and to combat any potential risk of greenwashing. However, previous experience in the debt capital markets is that prescriptive regulation may drive issuers elsewhere if bond issuance becomes overly burdensome, costly or risky, especially if there is little or no premium. There was a move away from retail issuance following the introduction of PRIIPs, MiFID II requirements and other regulation that made the selling of securities to retail more burdensome. Legislators therefore need to walk a tightrope with new green regulation; balancing market efficiency against their objectives to ensure any developments don't shrink markets and make it harder to finance change.

The EU Green Bond Regulation

The EU Green Bond Regulation provides for a voluntary label (EuGB label) for the green use of bond proceeds, which is being seen as a gold standard. The voluntary nature of the label is sensible due to the prescriptive requirements through which proceeds need to have been fully allocated before maturity of the bond according to the criteria set out in Article 3 of the Taxonomy Regulation.

The challenges of taxonomy alignment have been well documented. The proceeds must be allocated in a way that contributes substantially to one or more of the environmental objectives set out in Article 9 of the Taxonomy Regulation, does no significant harm to any other environmental objectives, and complies with minimum safeguards and technical screening criteria (TSC). There is a limited flexibility pocket for up to 15 per cent of proceeds that do not comply with TSC if relevant TSC have not entered into force by the date of issuance. The TSC are very detailed and require granular data to assess alignment. They also do not yet cover every activity that could be deemed to make a substantial contribution to environmental objectives.

In addition to these detailed requirements around the allocation of proceeds, use of the EuGB label will entail significant disclosure. The label requires a pre-issuance factsheet that must be reviewed externally, with the EU Green Bond Regulation mandating that reviewers register with the European Securities and Markets Authority (ESMA) and comply with certain conditions. The factsheet will need to address some forward-looking requirements, which may pose challenges, including how the bonds are expected to contribute to the issuer's taxonomy-aligned assets, turnover, capital expenditure and operating expenditure (for companies that required to report under the Corporate Sustainability Reporting Directive (CSRD)). There are also concerns around timing, as the launch of a new transaction could be delayed by the need to produce a factsheet before issuance.

There are other disclosure requirements, including an allocation report and review and impact report. The competent authority of the home member state will have supervisory powers over compliance with the disclosures, publication and will even be able to suspend trading in EuGB label bonds.

There may be a concern that a failure to meet the disclosure requirements could risk imposition of such measures, although it isn't yet clear exactly how the supervision will be conducted.

Moving away from the EuGB label, the EU Green Bond Regulation also provides an alternative, optional scheme of sustainability disclosures following voluntary templates for:

1. use of proceeds bonds not using the EuGB label, but marketed as environmentally sustainable, or
2. sustainability-linked bonds (SLBs). The rapporteur, Paul Tang, has said that this is for issuers "that are keen to show they are serious about their green claims but not yet able to adhere to the strict standards of the gold standard. With a clear system for disclosures, any green bonds not using this system will likely be looked at with increasing suspicion."

However, there may still be some challenges complying with these voluntary alternative disclosures, depending on the content of the guidelines the Commission needs to prepare. In particular, as under the EuGB label, an issuer subject to Article 8 of the Taxonomy Regulation (i.e., companies that will be required to sustainability report under the CSRD) will need to disclose how the bond proceeds are expected to contribute to the issuer's taxonomy-aligned turnover, capital expenditure and operating expenditure. This may involve forward-looking statements, which issuers currently prefer not to provide in debt prospectuses due to potential liability concerns. As mentioned earlier, there are also concerns surrounding the challenge of measuring taxonomy alignment.

While the EuGB label and alternative optional disclosures are, so far, voluntary, the EU Listing Act amendments providing for new annexes to the Prospectus Regulation for non-equity securities that are advertised as taking into account ESG factors or pursuing ESG objectives are worth noting.

A Commission statement from 19 October 2023 suggests these will take into account the experience with the voluntary guidelines that will be prepared for green bonds under the EU Green Bond Regulation. If the requirements for a Prospectus Regulation-compliant prospectus for a green bond track the voluntary guidelines for the alternative pre-issuance disclosures mentioned above, this would effectively make them mandatory and any concerns will depend on the content of those guidelines, as highlighted earlier.

The approach elsewhere

From a broader international perspective, most market participants follow the International Capital Market Association (ICMA) Principles. The ICMA's Green Bond Principles, Social Bond Principles, Sustainability Bond Guidelines and Sustainability-Linked Bond Principles are regularly updated to reflect the latest evolution of products and ESG thinking and constitute the prevalent voluntary standard for sustainable bonds.

In addition, and to avoid fragmentation, some national regulators have joined forces to develop common standards for green bond issuances. The ASEAN Green Bond Standards, for example, have been developed by South-East Asian capital markets authorities in conjunction with the ICMA's Green Bond Principles but provide more specific guidance for issuers in South-East Asia. Green bond issuances within the region often comply with both ICMA and ASEAN principles.

The Common Ground Taxonomy (CGT), which is the result of a comprehensive mapping exercise between China's and the EU's taxonomies, covers areas that are within the scope of both taxonomies. While there are no regulatory requirements to follow it, the CGT has piqued the interest of international markets since it was initially released in 2021 with some issuers labelling their green financial products as CGT-aligned.

Returning to the topic of regulatory developments, the UK government, as part of the overhaul of the UK prospectus regime, will delegate a greater degree of responsibility to the Financial Conduct Authority (FCA) in respect of admission to trading, including when a prospectus is required for admission and what it must contain. In the FCA's engagement papers¹¹ published in May 2023, it explores, for green, social or sustainability-labelled debt instruments, the desirability of strengthening the connection between the information provided in the prospectus and that described in other documentation such as bond frameworks. Obviously, the detail will not be seen until rules are drafted, but certainly the options outlined give the FCA scope to build on existing and evolving market practice. In addition, the FCA suggests that aspects of sustainability-related information could be included within the category of "protected forward-looking statements", providing alleviations from liability to encourage issuers to include more forward-looking information in their prospectuses.

At the moment, it therefore seems a UK green bond regulation is not on the horizon.

The need for flexibility rather than rigidity

Regulators must ensure issuers aren't driven away by rigid regulatory requirements while providing investors with the information they need to invest in green financial products that can be used to finance projects that will help achieve Net Zero. The current efficiency of the debt capital markets in relation to ESG bonds issued in line with existing ICMA principles needs to be respected by providing sufficient flexibility in order to deliver that change.

¹¹ "Admission to trading on a regulated market", "Protected forward-looking statements", and "Non-equity securities"

7. Will sustainability reporting and disclosure requirements improve ESG and financial performance?



Will sustainability reporting and disclosure requirements improve ESG and financial performance?



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Sustainability reporting and disclosure can bring many benefits, including greater transparency and increased accountability. But unless coupled with, and closely tied to, the implementation of a clear business strategy for sustainability, reporting and disclosure are unlikely to drive improved ESG performance or financial results. At the same time there is a huge variation in reporting frameworks across the world, with hopes for greater harmonization resting on the uptake of the International Sustainability Standards Boards (ISSB) standards

Sustainability reporting and disclosure seek to advance sustainability goals by improving decision-making and risk management, fostering stakeholder engagement, and enhancing transparency and accountability.

Sustainability reporting and disclosure help meet those aims when:

- the information covers the material ESG aspects of an organization, reflects their impact and performance in a balanced way, allows for benchmarking and verification, and follows recognised standards and frameworks

- the use of information is widespread and engages stakeholders with the capacity and interest to access, analyze, interpret, and use the information in their decision-making and risk management, and in their collaboration with reporting organizations and stakeholders
- the information leads to improved ESG outcomes for reporting organizations and their stakeholders, and enhances contributions to sustainable development goals and/or decarbonization goals through learning, innovation, and accountability

However, these criteria are not easy to assess. While sustainability reporting and disclosure can provide data and information on ESG impacts, outcomes, and business strategies, they may not necessarily influence the actual ESG performance and outcomes of the business. A 2021 Paper – [ESG and Financial Performance](#) by Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark – reviewed more than 1,000 studies published between 2015 and 2020 and found that there was a positive relationship between ESG and financial performance in 58% of the “corporate” studies, which focused on operational metrics such as stock price and return on equity (ROE), and return on assets (ROA).

The implementation of a well-developed sustainability strategy that drives better financial performance through innovation, higher operational efficiency, and improved risk management is key to a positive relationship. Simply measuring and reporting ESG metrics without an accompanying, robust sustainability strategy is not likely to be a strong performance driver.

An ongoing challenge, however, continues to be the fragmentation among jurisdictions in their regulatory approach to sustainability reporting and disclosure as a result of legal, political, and cultural nuances and differing degrees of ESG integration. For example, many countries in Asia Pacific, and Latin America have introduced green or sustainable taxonomies, or published proposals to do so (according to the Green Technical Advisory Group, there are more than 30 taxonomies in development globally).¹² In the United States, the US Securities and Exchange Commission is developing climate-related disclosure requirements for domestic and foreign registrants. California has recently enacted two laws that require covered entities to disclose greenhouse gas emissions and climate-related risks. Further, different organizations use a variety of approaches and methodologies, frequently resulting in inconsistent and incomparable information.

Looking ahead, the standards developed by the ISSB, released in June 2023, provide an opportunity for greater convergence and harmonization of sustainability reporting and disclosure practices.

International Financial Reporting Standards (IFRS) S1 establishes a disclosure framework for companies to communicate their sustainability-related risks across different time horizons, covering aspects such as strategy, governance, risk management, and performance. IFRS S2 complements S1 by providing specific climate-related disclosures, based on the company's greenhouse gas emissions, climate-related risks and opportunities, and climate-related financial impacts.

Both standards fully incorporate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This means that companies will not need to apply both the TCFD recommendations and ISSB standards; an entity applying IFRS S2 would also satisfy the TCFD recommendations. The ISSB standards provide a common baseline that jurisdictions can adapt for local needs; among the 30 countries that pledged to adopt or consider them, several expressed an intention to align with the global baseline as much as possible, while factoring in jurisdiction-specific considerations. This will help facilitate cross-border comparability, transparency and accountability of sustainability performance and its impacts.

The uptake of the ISSB standards relies on several factors, for example the endorsement of – and enforcement by – regulators, the availability of verifiable data, the capacity and willingness of companies and stakeholders to apply the standards, and the responsiveness and adaptability of the standards to new and emerging sustainability challenges.

Increasing stakeholder uptake depends, among other things (including enforcement), on ensuring that reporting and disclosure obligations are closely tied to performance, do not focus on unnecessary or inconsequential issues, and can realistically be met without unreasonable cost.

Critiques of this new era of transparency often focus on several of the points above, including in particular on cost, data availability and consistency, as well as skepticism about the extent of tangible benefits that reporting can produce. Harmonized sustainability reporting and disclosure standards will not necessarily resolve these questions, but they are likely to reduce the reporting burden and complexity for businesses, especially for those operating across multiple jurisdictions and sectors.

On balance, it is clear that widespread adoption of the ISSB standards should enhance accountability and encourage further integration of ESG factors into investment decisions and risk management. This will better align capital and corporate behaviour with sustainability goals and outcomes. While challenges remain, all signs point to the new ISSB standards having a genuine chance of achieving global acceptance.

¹² Green Technical Advisory Group, 'Promoting the international interoperability of a UK Green Taxonomy' (February 2023) page 1.

8. Infrastructure delivery for the route to Net Zero



Infrastructure delivery for the route to Net Zero



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Are regulations across the lifecycle of a low-carbon infrastructure project helping or hindering the transition? What structures helping the route to Net Zero have been introduced so far? In which fields is work still to be done by regulators?

Tackling climate change and achieving the transition to net zero will be the defining challenge of the 21st century. In an increasingly difficult political and economic environment, legislators and regulators will need to play their part by delivering a reliable and effective legal framework across the lifecycle of the products, services and infrastructure required to decarbonise the global economy. These include, among other things, the three phases of project development; (i) planning and permitting, (ii) construction and operation; and (iii) decommissioning.

Planning and permitting

Significant effort is currently being spent to accelerate the planning and permitting phase of low carbon energy projects. Multiple geopolitical crises, including the impact of the Russian invasion of Ukraine, underpin the urgency for change.

As far as planning law is concerned, legislators have developed new instruments to support the development and operation of Net Zero infrastructure. In Germany, for example, a number of federal acts include catalogues listing specific projects that are deemed to be of national interest; qualifying for this designation increases legal certainty, particularly where environmental standards may hinder quick progress, by providing for a binding legislative decision confirming the higher priority of renewable energy projects in situations where there is a conflict with other laws or interests. Further examples can be found at EU level where the Renewable Energy Directive (the third revision of which entered into force in November 2023) introduces concepts such as “renewable acceleration areas” and “areas for grid and storage infrastructure”.

In parallel to these more precise planning instruments, legislators and regulators are also aiming to accelerate permitting procedures. EU regulation establishes a framework stipulating that permitting procedures for renewables projects typically must be concluded within three months, otherwise projects are deemed permitted by default. Simultaneously, judicial review proceedings are being tightened. Again in Germany, court claims against permits for certain infrastructure projects such as LNG terminals have to be submitted immediately to the Federal Administrative Court – meaning legal procedures that usually have three steps are reduced to one.

Construction and operational phase

Besides changes in planning and permitting regulations there are a multitude of other developments that are having a direct and significant impact on the construction and operational phase of net zero projects.

A key driver for many projects is state funding, with the U.S. Inflation Reduction Act one of the most high-profile efforts to accelerate the energy transition (despite some recent setbacks in offshore wind projects). In response the EU has created the IPCEI instrument that supports funding for “Important Projects of Common European Interest” (which include infrastructure projects that are deemed to play an important role in the EU’s transition to Net Zero), while an EU Hydrogen Bank has been established to promote hydrogen-related projects and member state governments are taking on financial risks from gas grid operators who need to invest heavily to convert existing infrastructure for hydrogen. This mirrors the increasing importance of state financing in achieving Net Zero and may become a blueprint for future projects.

Trade restrictions are being tightened, with the European Union’s Foreign Subsidies Regulation – designed to tackle the alleged adverse effects on the EU internal market of subsidies granted by non-EU states – probably the best-known instrument. At the same time, we are seeing intense scrutiny of foreign investments under various FDI screening mechanisms that have been implemented or enhanced around the world in recent years, where there is an increasing focus on energy projects. Further, supply chain legislation is limiting flexibility and innovation – countries such as China now impose export restrictions on critical raw materials, while the EU has implemented its own raw materials regulations and requires businesses to screen their supply chains from an environmental and business and human rights perspective .

This has the potential to trigger conflicts as organisations scramble to source and import raw materials, for example for use in batteries.

States are also increasingly willing to take a more active role in sectors that they deem to be of critical importance to Net Zero. In Germany, energy companies Uniper and former Gazprom subsidiaries have been nationalised, while Rosneft subsidiaries have been subjected to operational control by the state. Germany is also pushing to become a shareholder in a number of electricity grid operators whose current stakeholders, at least from the government’s perspective, are not able or willing to invest in the upgrade of the country’s grid infrastructure.

Decommissioning phase

Decommissioning is a critical phase of the project cycle given the challenges of recycling products and components. Wind farms are a good example. Wind projects are key to achieving the Net Zero transition yet the farms themselves have short lifecycle of between 20 and 30 years and technological progress provides incentives to replace existing infrastructure with newer equipment. The increased efficiency of redeveloped sites conflicts to a certain extent with the need to decommission existing structures that are no longer needed, raising complex questions around how to reuse equipment such as rotor blades, which are made from a mix of difficult-to-recycle components. New technologies are needed – and frequently publicly funded – to develop skills and new business models in the recycling industry.

Conclusions

- Regulators around the globe have implemented a variety of strategies to accelerate the planning and permitting of Net Zero infrastructure. While the success of many of these measures remains to be seen, on the surface the changes should support the energy transition.
- Public funding and state support introduced in the recent past is likely to benefit the construction and operation of net zero infrastructure. However, increasing geopolitical tensions may raise new challenges for infrastructure investors and increase the need for legal support to deal with newly introduced and/or complex regulatory frameworks designed to protect domestic low carbon infrastructure assets.
- Regulators still need to address the challenge of how to decommission and recycle Net Zero infrastructure. Although first steps have been taken to find solutions, there is still significant work (including scientific research) to be done in the coming years.



9. Trade policy is vital for sustainability, but questions over legality remain



Trade policy is vital for sustainability, but questions over legality remain



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Trade policy is increasingly recognised as a key route to achieving global sustainability goals. Commitments to reach Net Zero require vast amounts of international investment to build green infrastructure and adapt existing systems. Free trade agreements can remove barriers to trade in sustainable products and technologies, while subsidies and tariffs can be used to incentivise the transition.

However, the legality of some of these measures is hotly debated, including whether they are compliant with international law. Trade and sustainability were also key topics of discussion at COP28, including the possibility of a more global approach to sustainable trade policy.

Trade policy measures in action

Trade policy measures are already being used to further the sustainability agenda and the trend is set to continue. To take one example, tariffs can be imposed on environmentally harmful products and removed to bolster trade in those that are environmentally positive.

Currently, the UK's Global Tariff, which applies to most goods imported into the UK, unilaterally removes tariffs on various items that benefit the environment or conserve energy and natural resources such as thermostats and heat pumps.

Meanwhile, the [Agreement on Climate Change, Trade and Sustainability](#), a proposed agreement between Costa Rica, Fiji, Iceland, New Zealand, Norway and Switzerland, will remove tariffs on more than 300 products related to clean energy generation and environmental monitoring and protection. It will also develop principle-based guidelines for voluntary eco-labelling programmes and develop environmental services.

At the same time, the EU and the U.S. continue to negotiate the [Global Arrangement on Sustainable Steel and Aluminium](#), which seeks to impose tariffs on carbon-intensive imported metals. Similarly, the EU's carbon border adjustment mechanism (CBAM) will impose a carbon price designed to level the playing field between certain carbon-intensive products originating in the EU and equivalent products imported from third countries with less stringent emissions regulations (see our latest article on the EU CBAM [here](#)).

From tariffs on high carbon goods to technical regulations that set emissions targets, well-designed trade policy is critical to deliver Net Zero. But there is growing debate over whether such measures are compatible with international law

The price of EU CBAM certificates, which in-scope businesses will have to purchase and surrender in proportion to the embedded emissions of certain goods imported into the EU, will reflect the average weekly carbon price under the EU emissions trading scheme. More recently, the UK announced in December 2023 that it will be introducing its own CBAM to be implemented by 2027 (see our article [here](#)).

Subsidies are also being deployed by countries on a vast scale. The Biden administration's [Inflation Reduction Act](#) directs nearly USD400 billion of federal funding to clean energy through a mixture of tax incentives, grants, and loan guarantees. Clean transportation, as well as clean electricity and clean transmission, are among the beneficiaries. Jurisdictions such as Japan are following suit (see our article [here](#)).

Non-tariff trade measures such as technical regulations can also set emissions targets for producers or support the adoption of energy-efficient technologies.

The politics of free trade agreements

Negotiations relating to free trade agreements (FTAs) increasingly centre on the inclusion of environmental considerations (see our previous article on this here). FTAs play an important role in opening up international markets, thereby facilitating the flow of goods and services, and countries are progressively focusing on “green trade”, which includes the trade of environmentally-positive goods and services, as noted by the UK’s [Green Trade Report](#).

One example is the 2022 UK-New Zealand FTA which contains [a number of environmental provisions](#). Notably, it seeks to liberalise tariffs on the most comprehensive list of environmental goods in an FTA, including electric vehicles and wind turbine parts. It also promotes investment in environmental goods and services, takes steps to eliminate fossil fuel subsidies, and makes commitments for the two countries together to tackle issues such as deforestation.

Similarly, the EU has included requirements to implement the Paris Agreement, and to protect biodiversity, into a [proposed trade deal with Mercosur](#), the trading bloc which includes Argentina, Brazil, Paraguay and Uruguay. The EU’s FTA with New Zealand is also expected to enter into force early this year. Hailed as the EU’s gold standard for green trade deals, the agreement will liberalise trade in green goods and services and includes a dedicated provision on the reform of trade and fossil fuel subsidies.

Questions over compliance with international law

It is clear that trade policies can help to push forward the sustainability agenda, but their legality under international law has been heavily debated. Detractors note that tariffs imposed based on carbon intensity discriminate against developing countries that often do not have the ability to invest heavily in sustainable practices. Indeed negotiations over a comprehensive economic partnership agreement between the EU and Indonesia stalled when Indonesia’s chief economic minister [accused the EU](#) of “regulatory imperialism” with its deforestation law, which Indonesia argues will hurt its small palm oil farmers.

A particular point of focus has been the EU’s CBAM, which has faced strong opposition from countries such as [China](#) and [India](#), who argue that it will discriminate against imported products and limit market access contrary to WTO law. Ultimately, the WTO’s dispute resolution body may be asked to adjudicate. Meanwhile, investor-state litigation continues to be used by companies to challenge sustainability measures. For example, TC Energy Corporation is [seeking](#) more than USD15 billion in compensation from Washington for the cancellation of the Keystone XL pipeline.

Looking ahead: from bilateral to multilateral

The COP28 conference gave us a glimpse into a potential future of multilateral solutions rather than bilateral or unilateral policy measures. At the conference in Dubai the WTO Secretariat, in cooperation with organisations such as the United Nations Conference on Trade and Development (UNCTAD), led the first ever COP “[trade day](#)”. In parallel UNCTAD released a [study](#) examining how developing countries have integrated trade into their Nationally Determined Contributions. The research revealed trade policies’ “untapped potential” in advancing climate goals.

To help unlock this potential, the WTO has launched a [trade policy toolkit](#) to help governmental efforts to meet global climate targets through trade. Among other points, the WTO is encouraging the use of international standards to avoid fragmentation when upgrading energy efficiency regulations, and has also called for the greater coordination of climate-related internal taxes, including carbon pricing and equivalent policies, to reduce policy fragmentation and compliance costs. Following the conclusion of COP28, on 25 January 2024, 76 WTO members took part in the [Trade and Environmental Sustainability Structured Discussions](#), which envisages a global trading system that protects and preserves the environment in accordance with sustainable development. By focusing on global alignment, accusations of protectionism and discrimination will hopefully give way to positive dialogue on sustainability and trade.

10. Embedding sustainability
in practice – how companies
will need to adapt to successfully
address sustainability-related
regulation



Embedding sustainability in practice – how companies will need to adapt to successfully address sustainability-related regulation



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Financing the transition to Net Zero will necessitate fundamental changes to the businesses are managed. Here we take a look at practical steps senior leaders can take to address the challenges they face

The transition to Net Zero presents companies with a host of challenges as they adapt to the physical, regulatory and commercial risks and opportunities that a low-carbon economy will bring. These include significant volumes of new regulation, pressure from investors, customers and activists, and stringent disclosure requirements.

A company's organisational purpose, vision and values will need to align with its Net Zero transition plan and support the transformation required. Boards and senior management are likely to find themselves weighing commercial considerations alongside sustainability factors and commitments, requiring different approaches to assessing value and measuring performance.

The regulatory environment is evolving rapidly, with a multitude of new requirements and expectations that are not straightforward to implement. Identifying and tracking these regulations is a challenge in itself, but as companies do so they also need to embed changes in a way that ensures compliance is future-proofed against evolving and maturing market practice and regulatory expectations.

Much of the emerging sustainability regulation is not a “one and done” exercise, and businesses' systems and processes will require constant attention.

Change is required across all levels of an organisation, from governance frameworks to board and senior management roles and responsibilities, risk management and compliance frameworks and operating models.

Some practical steps that successful companies are taking to drive this internal transformation include the following.

Organisational culture and purpose: embedding sustainability across an organisation does not happen without a change in culture and mindset, and requires senior sponsorship to demonstrate the importance to the business and set the tone from the top. This can be supported by clarity on how the sustainability strategy aligns with corporate purpose and values.

Governance framework: to embed sustainability into their day-to-day activities, businesses will need to review and update their governance frameworks to reflect sustainability strategies and priorities, and build these into their existing structures.

Some companies are creating new board and executive-level sustainability committees to drive greater focus on strategic direction and progress against plans, and to ensure clear ownership.

Roles and responsibilities: all areas of an organisation are impacted by the sustainability agenda. Reviewing and redefining roles and responsibilities drives accountability and minimises the risk of inefficiency and confusion. This includes ensuring appropriate division of responsibility between the board and senior management, clarity on decision-making powers, and the creation of mechanisms to provide effective oversight of delivery.

Objectives and incentives: businesses should also consider how to embed sustainability objectives into personal and business-level performance management and incentive structures in order to drive the necessary focus. When calibrated correctly these support boards to hold managers to account for the delivery of the sustainability strategy. Alongside this, appropriate management information is required to effectively support oversight of progress.

Product governance: updating product governance frameworks to effectively mitigate greenwashing risks requires more than simply drafting a new product approval policy. Instead, sustainability factors should be embedded into the end-to-end product lifecycle, including target market, product design, product approval authorities (across business and compliance areas), and post-launch product monitoring (supported by relevant KPIs and KRIs).

Risk management framework: sustainability risk management should be integrated within an organisation's existing risk framework and taxonomy, including appropriate sustainability risk appetite and tolerances as well as consistent processes for identifying, quantifying and mitigating sustainability risks. Appropriate integration to the existing risk framework is essential to enable the organisation to weigh commercial decisions on the basis of a robust picture of the overall risk position.

Compliance: The compliance function can play a key role as a strategic partner to the business, given the stage of sustainability development and combination of evolving regulatory requirements and market standards. Companies should consider the operating model of their compliance function in order to support the needs of the wider organisation. This may include ensuring compliance has sufficient skills and experience to advise and challenge the business (which may be at the cutting edge of new products and services), or to consider a regulatory engagement strategy to understand and, where possible, contribute to supervisory approaches as these develop alongside market practice.

These challenges – and the steps taken by organisations to address them – are interconnected, and as a result, a holistic approach is required.

For example, a board's ability to make informed decisions on whether commercial strategy aligns with sustainability commitments requires (among other things) comparable and effective internal management information and metrics on the business's activities and risks. This in turn is dependent on sustainability being embedded effectively within the risk management framework, with a clear internal standard for monitoring and measuring sustainability factors across different products, services and activities.

Business leaders should take steps to embed sustainability across key areas of their organisation – including their governance framework, risk management and compliance functions – with a view to ensuring the successful delivery of their sustainability strategies and Net Zero plans.



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