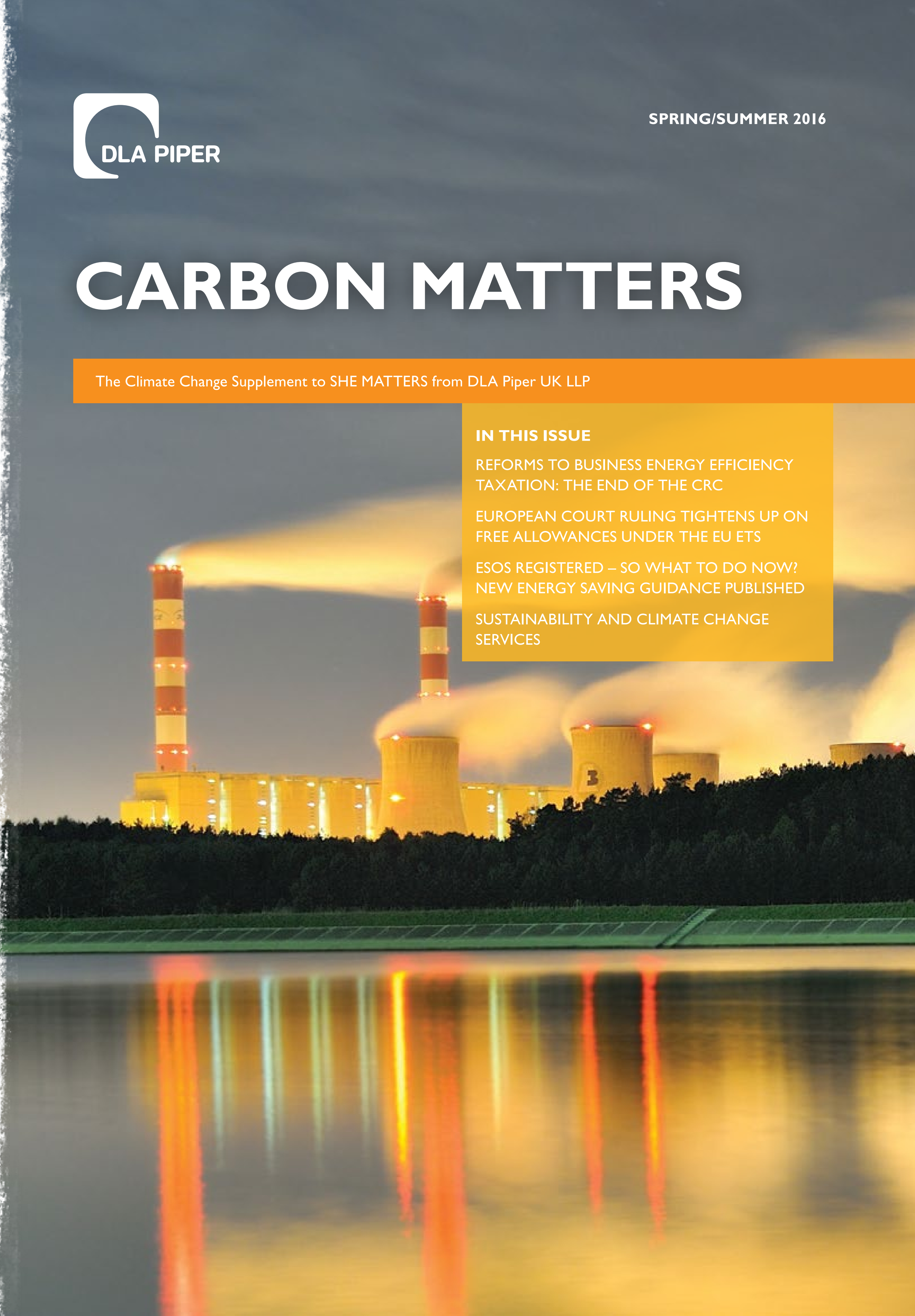

SPRING/SUMMER 2016

CARBON MATTERS

The Climate Change Supplement to SHE MATTERS from DLA Piper UK LLP

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CARBON **MATTERS**

Teresa Hitchcock
Partner

Robust international and national action on climate change looks increasingly likely following the high-profile Paris Agreement signing ceremony at the United Nations in New York in April.

In New York 175 governments including the US, China and India, took a symbolic first step of signing onto the deal, setting a new record for the largest number of countries to sign an international agreement on one day. China, which accounts for 20 percent of global emissions, said it will finalise domestic procedures to join the agreement before the G20 meeting in September. Other major industrialised countries including the US offered similar pledges to pursue the necessary domestic processes towards approval in 2016.

The Paris Agreement will enter into force when countries representing at least 55 percent of total global greenhouse gases formally join the agreement. In New York 34 countries representing 49 percent of global greenhouse gas emissions formally joined the agreement, or committed to joining the agreement as early as possible this year. Under the timeframe agreed in Paris it was expected that the Agreement would not become operational until 2020 but the momentum gained in the run up to the New York signing now means that this may happen as early as late 2016 or early 2017. The US also represents around 20 percent of global greenhouse gas emissions and therefore combined actions by China and the US make up the majority of the necessary commitment to see the Paris Agreement enter into force. Although the US signed the Kyoto Protocol it never ratified the treaty. A number of the Small Island Developing States – amongst the countries most vulnerable to climate change – have already ratified the Paris Agreement, with leadership taken by Fiji and the Maldives.

Governments of almost 200 nations reached agreement in Paris that tackling climate change is imperative and that doing so provides an opportunity to drive economic growth. The United Nations Framework Convention on Climate Change (UNFCCC) Agreement seeks to avoid catastrophic climate change by limiting global warming to 1.5 °C to 2 °C, which means getting to “net zero emissions” between 2050 and 2100.

The **UNFCCC Agreement** contains binding obligations for all signatories to set national emission reduction targets and report in a transparent and frequent manner on how they are progressing against those targets. The accompanying reporting and transparency frameworks will be discussed in the run up to this year's UNFCCC Conference of the Parties (COP) in Morocco. Implementation processes will be the primary focus for the UNFCCC over the next 18 months and work to strengthen pre-2020 action will also include broader engagement with non-state actors.

Paris is a key milestone in the transition to a low-carbon economy and signifies a major shift in momentum. The New Climate Economy Report, launched by UN Secretary-General Ban Ki-moon before the Paris summit, estimates that a total of US$90 trillion will be invested in infrastructure in the world's cities, agriculture and energy systems by 2030 and the International Energy Agency estimates that achievement of the pledged national commitments will require public and private sector investment of around US$16.5 trillion.

In the UK Energy minister Andrea Leadsom has said that the Government will enshrine in law a long-term goal of reducing carbon emissions to zero, increasing the current target established under the Climate Change Act. The UK is already legally bound to reduce emissions by 80 percent by 2050. The Committee on Climate Change has recommended that the fifth carbon budget under the Act should stipulate a cut of 57 percent by 2032.

The Department of Energy and Climate Change is currently formulating a variety of new policy responses to support action towards meeting UK requirements under the Act and it is likely that these will be clearer by the time the Chancellor delivers his Autumn statement. The CRC Energy Efficiency Scheme is to be abolished and key issues include the long-term direction for Carbon Price Support rates and the Carbon Price Floor.

Last year was the hottest year on record by a significant margin and also saw atmospheric concentrations of CO_2 increase by the highest amount on record. Businesses will increasingly be expected to demonstrate that they are prepared for more stringent emissions policy scenarios and increasing climate impacts. The new G20 Financial Stability Board Taskforce on Climate-related Financial Disclosures, chaired by Michael Bloomberg, is developing reporting guidelines this year to encourage transparency and preparedness on these issues. Going forward it is likely that certain Stock Exchanges will expect listed companies to report on climate risk metrics and management.

REFORMS TO BUSINESS ENERGY EFFICIENCY TAXATION
THE END OF THE CRC

On 16 March 2016, as part of his Budget Statement, George Osbourne announced the abolition of the CRC Energy Efficiency Scheme to take effect from the end of the 2018/19 compliance year.

This was no rabbit out of the Chancellor's hat, however, as the Government's intentions had been made fairly clear last year in its consultation in the autumn of 2015 on reforming energy efficiency taxes and reporting.

On the same day the Treasury published its formal response to that consultation, which sets out further detail on the timetable for abolition of the CRC Scheme and outlines the Government's plans for consequential changes to the Climate Change Levy (CCL), which will constitute the single business energy tax. The Government's spin, which suggested that it was relieving businesses of a costly and bureaucratic burden, rather than skirted round the fact that the CRC Energy Efficiency Scheme was not originally intended as a tax at all, but as an emissions trading scheme. It was intended to apply the principles of emissions trading to less energy intensive businesses and the public sector, with a "light regulatory touch".

It was the Coalition Government's September spending review of 2010 which turned the CRC Scheme into a tax by abolishing the revenue – recycling based on league table performance which was intended to make the scheme "revenue neutral", so that instead the proceeds of the sale of allowances could be diverted to the Treasury. The truth, however, is that no emissions trading scheme can be entirely simple, which is why the European Union Emissions Trading System (EU ETS) focuses largely on energy intensive industrial sectors, which are already subject to comprehensive environmental regulation. Because of the broad scope of the CRC Scheme, which covers both public and the less energy-intensive parts of the private sectors; because it is based on "organisations", rather than companies or other corporate bodies to discourage avoidance; and also because it makes special provision to cover franchising operations and tenanted properties to broaden the scheme's scope still further, the rules have become particularly complicated.

Given that the scheme has not been effectively functioning as an emissions trading scheme, there seems to be much to be said for the present decision to abolish the scheme, but retain CCL. In principle, the fact that CCL has a broader tax base should mean that the burden of making good the loss to the Treasury of the revenue stream from the CRC Scheme will be distributed more evenly.

Not all of the hard graft will have been wasted. The CRC Scheme does appear to have had noticeable effects in reducing energy consumption by affected organisations. However, this may have been due less to the actual operation of the scheme, as to the fact that the need for preparation for compliance showed considerable scope for energy savings.

The Government's response to the consultation indicates that as a result of the closure of the scheme no allowances will need to be purchased in respect of energy supplied from April 2019 onwards. Final reports under the scheme will be due to be made by the end of July 2019, and surrender of allowances in respect of energy supplied in the 2018/19 compliance year will be due by 31 October 2019.

There will be an increase in rates from CCL to compensate for the lost revenue from the CRC Scheme. The rates will also be changed from April 2019 onwards and over the period to 2025, in order to encourage reductions in gas consumption.

In order to protect energy intensive sectors the CCL discount for parties to Climate Change Arrangements will be increased to ensure that they effectively pay no more than RPI increases in CCL. Furthermore existing eligibility criteria for Climate Change Agreements will be maintained at least until 2023. The review of targets for parties to Climate Change Agreements will recommence later this year.

The response also announced that the Government will consult later this year on a simplified energy and carbon reporting framework.

For further information, please contact:

Teresa Hitchcock
Partner
T +44 114 283 3302
teresa.hitchcock@dlapiper.com

EUROPEAN COURT RULING TIGHTENS UP ON FREE ALLOWANCES UNDER THE EU ETS

A multi-jurisdictional challenge to a Commission Decision governing the allocation of free allowances to industrial operators under the European Union Emissions Trading Systems (the EU ETS) has resulted in the Commission Decision being quashed by the Court of Justice of the European Union (CJEU). Free allowances allow operators to match their emissions of carbon without having to purchase the allowances at auction, or buy them from other operators who have reduced their emissions, or who for other reasons have a surplus of allowances. The result of the court judgment is that the Commission will have to prepare a new Decision so that the amount of future allocations of free allowances under the scheme can be re-calculated.

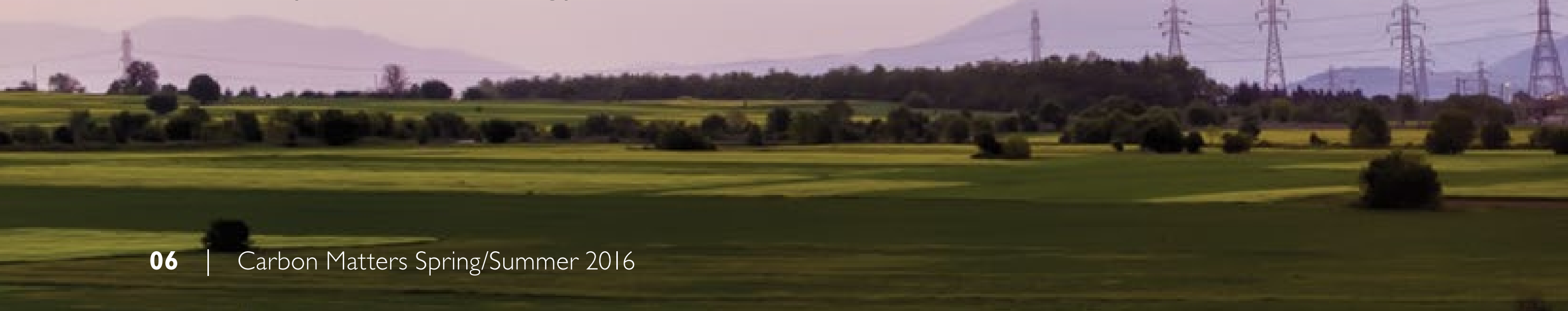
A member of industrial operators across the EU had brought legal proceedings challenging the Decision, complaining that their allocation of free allowances for the third phase of the scheme, which runs from 2013-2020, was too low. Under the rules set out in the Directive for allocating the amount of allowances allocated free to industrial operators (as opposed to being auctioned) the Commission was required to calculate a cap of the total number of allowances allocated free to those operators (the Industrial Cap) and if necessary apply a correction factor (the Cross-Sectoral Correction Factor) to reduce the provisional allocations of allowances which would have been made to such operators on the basis of past emissions, so that they fell within the Industrial Cap.

The operators complained that in making this calculation, the Commission had fixed the Industrial Cap too low, as a result of misinterpreting the rules, and had accordingly applied too high a Cross-Sectoral Correction Factor.

The procedure by which the Decision was challenged was cumbersome. Case law of the CJEU establishes that only in certain very restricted cases where they have direct standing before the Court itself can businesses challenge legislation directly before it. Nevertheless, Community Law requires them to have a remedy if they are challenging the lawfulness of acts of Community institutions. Accordingly, in a case such as this, operators are obliged to bring their challenges before national courts, and challenge, not directly the lawfulness of the relevant Community Act, but the lawfulness of the national implementing measures. However, national courts cannot examine the legality of the Community Act on which such measures are based, but must refer the matter to the CJEU for a preliminary ruling. In this case references were made by national courts in Austria, the Netherlands and Italy. National proceedings were also brought elsewhere, notably in the UK, but no further references were made, on the ground that the issues had already been raised sufficiently.

The CJEU confirmed that in respect of the standing issue, the correct procedure had been followed by these operators who were represented in the reference proceedings by bringing national proceedings rather than attempt to sue directly in Luxembourg.

Sadly for the operators, on the substantive issues before the Court, the CJEU did not accept the various arguments put forward on behalf of the operators. Instead, it followed the previous opinion of the Advocate General which was delivered in November last year. According to that opinion, the determination of the Industrial Cap by the Commission had in fact been too high.



This was because, in applying a provision requiring an enlargement of the Industrial Cap to take account of emissions from installations which had only joined the system in Phase III, the Commission had taken account of data from Member States which in some, but not all cases, had also included emissions in respect of the same activities by installations that had been covered by the Scheme before 2013.

As was made clear by the Advocate-General's opinion, the drafting of the Directive left much to be desired in terms of clarity, and there were significant differences in the various different language versions of the text. The solution which she proposed and which was ultimately adopted by the Court, was that which best served the purposes of the Directive in discouraging carbon emissions from relevant plant.

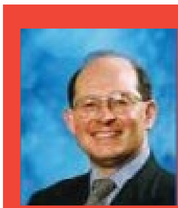
Accordingly, the Commission Decision was annulled, but not for the reasons put forward on behalf of the operators. The Commission was ordered to prepare a new decision within ten months of the decision, and future allocations will therefore need to be made on the basis of a lower Industrial Cap and therefore a higher Cross-Sectoral Correction Factor.

The operators who brought the proceedings can take some comfort from the fact that, in the interests of legal certainty, the declaration of the CJEU will not take effect until the end of the ten month period from the date of delivery of the judgment. That means that measures adopted prior to the expiry of that period, on the basis of the annulled provisions, cannot be called into question.

Nevertheless, it appears that the judgment will inevitably result in a reduction in the amount of free allowances allocated in future, both in Phase III and Phase IV of the EU ETS. That will be welcomed by those who have complained that the EU ETS has been ineffective due to too low a carbon price.

As far as the operators are concerned, many of the litigants were operators in sectors at risk of carbon leakage (i.e. competition from similar industries based in countries where the EU ETS or similar trading schemes do not operate). They will have to hope that the Commission and Member States will agree on the need to support them against the threat of that competition.

For further information, please contact:



Noy Trounson
Barrister in Employed practice
T +44 207 796 6318
noy.trounson@dlapiper.com

ESOS REGISTERED – SO WHAT TO DO NOW?

NEW ENERGY SAVING GUIDANCE PUBLISHED

The Department of Energy and Climate Change (DECC) has published a guide aimed at assisting organisations in implementing energy savings identified as part of the work they have undertaken to comply with the Energy Savings Opportunity Scheme (ESOS).

It is understood that over 6,000 organisations have completed the ESOS registration process, an exercise that will have created headaches for facilities and energy managers over the last 18 months. The original registration deadline in December 2015 was extended to the end of January 2016 due to the number of companies known to be scrabbling to complete audits and to produce compliance packs to meet the new regime's requirements.

Now, those organisations have met the initial reporting and registration challenge and it is unclear how many will simply sit back until the next ESOS's deadline in a few years as opposed to actually thinking seriously about implementing some of the energy saving opportunities identified during the audit process. The DECC guide, which was prepared jointly with the Carbon Trust, summarises what businesses could do to implement such recommendations. Guidance is provided on preparing business cases for energy savings and on assessing project financial viability.

It is understood that Government analysis has indicated that if only 5 percent of the energy opportunities identified through ESOS audit process were to be implemented, the businesses could collectively achieve annual savings of over £250 million. This would of course be one of the key ambitions behind the implementation of ESOS, alongside assisting in meeting the UK's climate change targets.

It is anticipated that the guide will be of particular help to businesses with less in-house knowledge on how to implement energy savings and how to make the business case for such matters more attractive. It highlights the fact that in many cases energy efficiency does not necessarily mean investing vast sums and simple measures, such as installing or optimising lighting or heating control systems or engaging with staff to change behaviour, can lead to relatively significant cost savings. Aside from assisting in building a business case, the guidance also seeks to help in relation to project implementation, monitoring and verification.

On the other side of the fence from those organisations that may proactively seek to implement energy efficiency opportunities, are those organisations that did not meet the ESOS submission deadline. Whilst the Environment Agency indicated that it may regulate with some sympathy in the initial stages of the new regime, we are now reaching the time period when that approach may cease and enforcement action may be likely over the coming months.

For further information, please contact:

Alastair Clough
Legal Director
T +44 114 283 3114
alastair.clough@dlapiper.com

SUSTAINABILITY AND CLIMATE CHANGE SERVICES

Following the December 2015 Paris Agreement on climate change the level of climate-related regulation through national and regional plans ramps up regulatory change related to greenhouse gas emissions. Under the United Nations Framework 195 nations have committed to five year reviews to ensure progress towards a stretching global target of limiting global warming to "well under 2 °C".

Over the coming years we will need huge changes to business processes, infrastructure, energy generation and transportation and these changes can drive positive and sustainable growth for innovators who unlock new market opportunities. The low-carbon economy is already worth US$5.5 trillion a year and US$90 trillion will be invested in infrastructure in the world's cities, agriculture and energy systems by 2030 – creating an unprecedented opportunity to drive investment in low-carbon growth and generating innovative, agile and resilient organisations.

Companies and public sector organisations must respond to this fast-evolving landscape. Key issues include carbon pricing (tax and or market-mechanisms), emissions and efficiency standards, resource scarcity, subsidy reform and investment incentives. Businesses will increasingly be required to disclose climate change impacts and risk exposure and sustainability, and climate change credentials are coming under greater scrutiny from governments, consumers, employees and investors.

DLA Piper's expert knowledge of strategic advice on sustainability and climate change helps clients understand emerging market trends to position innovative businesses "ahead of the curve" enabling them to reduce costs and manage risk.

DLA Piper's Safety Health and Environment (SHE) Group is one of the largest specialist teams in a law firm. We have a unique blend of leading advisory practitioners and defence lawyers, many of whom have been regulators, or have prosecuted on behalf of regulators at an earlier stage in their careers. Our advice is also integrated with global professional policy and regulatory services, strategic communications and government relations.

Our work includes advice to industrial organisations on compliance issues, environmental input into corporate finance and property transactions, preparation of due diligence studies, negotiation of contractual protections, supervision of remediation strategies to reduce liabilities and the provision of specialist advice in connection with environmental litigation.

Value-added sustainability and climate change services include advice on:

- sustainability and climate change strategy design and implementation
- sustainable products and services – risk exposure and management, opportunity positioning and future-proofing
- environmental reporting and performance benchmarking
- carbon reduction and sustainable procurement

For further information, please contact:

Micael Johnstone
International Sustainability & Climate Change Consultant
T +44 207 796 6806
micael.johnstone@dlapiper.com

www.dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities.
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