February 2024

Insights and perspectives on governance, disclosure & litigation

ESG Matters

This monthly update helps you keep up with the latest developments in ESG governance, disclosure and litigation.

1 EU ETS: extending and strengthening the Emissions Trading System

In May 2021, the EU adopted a binding greenhouse gas emission reduction target of 55% by 2030, compared to 1990 levels. One of the EU's main instruments to achieve this target is the European Emissions Trading System (EU ETS). The EU ETS is a so-called cap-and-trade-system: EU emissions are capped by issuing a limited number of allowances to emit for sectors covered by the system and allowances can be traded. The EU ETS has been in place since 2005 and is undergoing a major overhaul per 2024. The main changes are the following. From 2024, the maritime sector is covered by the EU ETS and from 2026, the aviation sector will no longer receive free emission allowances. Other EU ETS sectors also face the phasing out of free allowances. At the same time, the European industry will be protected by the introduction of the Carbon Border Adjustment Mechanism (CBAM), which requires importers of CBAM goods – such as steel, electricity and hydrogen – to pay a carbon price. In addition, the Social Climate Fund will start in 2026. From 2027, a new EU ETS will cover the emissions from fuel combustion in buildings, road transport and other sectors.

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Shipping sector

Maritime transport is subject to the EU ETS from 1 January 2024, and will be required to comply with emission monitoring and reporting obligations and to surrender emission allowances for a part of their emissions. The obligation to cover emissions of large ships will be phased in gradually: 40% of emissions will have to be covered by emission allowances in 2024, 70% in 2025, and all emissions from 2026 onwards. In practice, we see that shipping companies are in the process of opening Maritime Operator Holding Accounts in the EU ETS Registry and are preparing for the new reporting requirements.

Aviation sector

The aviation sector is also facing stricter rules. The free allocation of emission allowances will be phased out over the next few years. From 2026, the sector will no longer receive free allowances and all allowances will be auctioned. Under the European ReFuelEU regulation, aviation fuel suppliers will also have to blend increasing amounts of sustainable aviation fuels (SAF): a minimum of 2% by 2025, 6% by 2030 and 70% by 2050. To ensure the production and long-term availability of SAF, the sector will increasingly need to enter into agreements with other market players and sectors in the coming years.

Further strengthening of EU ETS

In addition, all existing EU ETS sectors will face an accelerated reduction in the total number of emission allowances to be issued under the EU ETS (the cap). The percentage by which this number is reduced will be increased from 2.2% to 4.3% from 2024 and to 4.4% from 2028. There will also be one-time cap reductions, of 90 million allowances in 2024 and 27 million in 2027. Free allocation of emission allowances will also be phased out from 2026, resulting in no free allocation in any sector from 2034.

Carbon Border Adjustment Mechanism

The phasing out of free allowances is expected to have a negative impact on the competitive position of European companies. The Carbon Border Adjustment Mechanism aims to protect the level playing field for European companies covered by the EU ETS. From October 2023, importers of CBAM goods such as iron, steel, cement, electricity and hydrogen have to report the amount of greenhouse gases emitted during the production of these goods (outside the EU). From 2026, importers will actually have to pay a price for these emissions. They will have to buy CBAM certificates through a central IT platform that is being developed by the European Commission. The price of a CBAM certificate will be based on the average auction price of allowances under the EU ETS. This will align the carbon price adjustment for CBAM imports with the ETS price as much as possible.

EU ETS 2: fuel in the built environment, road transport and other sectors

A new emissions trading system, called EU ETS 2, will cover fuel use in the built environment, transport and other sectors not covered by the EU ETS. The obligation to monitor emissions and pay the CO2 price will apply to fuel suppliers (upstream) rather than end users (downstream). As the EU ETS 2 will take full effect from 2028, fuel suppliers need to take preparatory steps now. Fuel suppliers must have an emissions permit before 1 January 2025 and have to apply for a permit from the Dutch Emissions Authority (NEa) in the second half of 2024. Fuel suppliers should start preparing the permit application and the associated monitoring plan in the coming months.

Social Climate Fund

In addition, a social climate fund will be set up to help vulnerable households, small businesses and transport users most affected by energy and transport poverty. Measures that could be financed by the fund include reducing energy taxes and charges, promoting the renovation of buildings, or developing a second-hand market for electric vehicles. The fund will be launched in 2026, one year before EU ETS 2 enters into force. It will be co-financed by the auctioning of allowances from the EU ETS 2.

What this means for you:

- **Shipping.** The shipping sector is subject to the EU ETS from 1 January 2024. Market participants are currently in the process of opening Maritime Operator Holding Accounts in the EU ETS Registry and will have to comply with all monitoring and reporting requirements for the first time in the coming year.
- **Aviation.** The aviation sector will face the phasing out of free emission allowances in the coming years and will therefore experience higher costs for buying emission allowances. The future blending obligation is a reason to think about the production and procurement of sustainable aviation fuel.
- **CBAM.** Importers of CBAM goods such as iron, steel, cement, electricity and hydrogen have been subject to specific reporting requirements since October 2023 and will have to buy CBAM certificates from 2026 to place the goods on the European market.
- **Built environment and road transport: EU ETS 2.** Fuel suppliers to these sectors must have an emissions permit by 1 January 2025 and will have to submit their permit application to the NEa in the second half of 2024. Fuel suppliers should therefore start preparing their permit application and the corresponding monitoring plan in the coming months.

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2 Spotlight on ESG developments

Governance & transition

Final text of the CSDDD proposal available

On 24 January, the European Parliament, Committee and Council concluded technical negotiations on the proposal for the Corporate Sustainability Due Diligence Directive (CSDDD), resulting in a final text. This text will be voted on by the Council and JURI committee in February. A final vote on the text is expected in April 2024. Read more in our latest update on the CSDDD proposal.

Platform on Sustainable Finance launches 'Compendium of Market Practices' report

On 29 January, the EU Platform on Sustainable Finance published a report providing insights into how the EU Taxonomy and sustainable finance framework support financial and non-financial actors in their net zero transition. The report focuses on seven stakeholder groups: corporates, credit institutions, investors, insurers, auditors and consultants, small and medium-sized enterprises and the public sector. The report spans three areas: (i) the EU sustainable finance framework for business strategy and transition planning; (ii) finance and transactions, including observations on the adoption of EU tools and frameworks by market participants; and (iii) reporting, monitoring, and assurance. The report's annex provides case studies for each stakeholder group.

Council adopts negotiation mandate on EU regulation on forced labour

On 26 January, the European Council adopted its negotiation mandate on the proposed EU regulation on forced labour. The proposal prohibits the placing, making available on the EU market and export to third countries of products made with forced labour. Competent national authorities should investigate reasonable indications that products were made with forced labour. In cases of forced labour, the authorities shall withdraw or ban the placement and export of these products. Companies may be required to dispose of the products. The Council mandate proposes, inter alia, that the EC should take over (pre-) investigations into forced labour if the potential violation is of Union interest. The EP, the EC and the Council will now initiate inter-institutional negotiations on the proposal.

ECB publishes report on risks from misalignment of banks' financing with EU climate objectives

On 23 January, the European Central Bank (ECB) published a report on the climate transition risks for banks' credit portfolios. The report shows that the euro area banking sector is significantly misaligned with EU climate objectives and may therefore be exposed to increased transition risks. In addition, around 70% of banks are exposed to elevated reputational and litigation risks. Banks can use the approach described in the report to further develop their alignment assessment capabilities in order to identify the transition risks they face and to comply with the forthcoming disclosure requirements under the EBA's Implementing Technical Standards on Pillar 3. In a recent blog, ECB Executive Board Member Frank Elderson argues that banks should identify, measure and, above all, manage transition risks in the same way as any other material risk.

NGFS publishes guidance on the purpose and use of the NGFS scenarios

On 23 January, the Network for Greening the Financial System (NGFS) published a technical document on the purpose and use of the NGFS scenarios. Since their initial release, the NGFS scenarios have played an important role in helping central banks, supervisory authorities and other financial institutions explore the implications of different potential futures related to climate change and transition. The document sets out the purposes and practical applications of the NGFS scenarios, recognising the need for scenario users to clarify what they are trying to achieve and to consider how the scenarios enable them to meet their objectives and specific needs, and concludes with frequently asked questions. The online version will be updated regularly.

EBA launches a consultation on guidelines on ESG risk management

On 18 January, the European Banking Authority (EBA) launched a public consultation on draft guidelines setting out requirements for institutions to identify, measure, manage, and monitor ESG risks, including through plans aimed to address risks arising from the transition towards a climate-neutral EU economy. These guidelines set out principles for the development and content of institutions' plans under the Capital Requirement Directive (CRD6) to monitor and adequately address the financial risks stemming from ESG factors, including those arising from the transition process towards the EU's 2050 climate neutrality goal. The consultation is open until 18 April 2024.

Disclosure

CSRD: MEPs agree to delay adoption of sustainability reporting standards for certain sectors and third-country companies

On 24 January, Members of the European Parliament (MEP's) voted in favour of the EC proposal to postpone the adoption deadline for (i) sector-specific sustainability reporting standards and (ii) general sustainability reporting standards for third country companies until June 2026. MEPs believe that sector-specific sustainability reporting standards enable comparisons between companies and are therefore a valuable source of information for investors. They suggested that the EC publishes eight sector-specific reporting standards as soon as they are ready before the deadline.

EFRAG launches public consultation on two exposure draft ESRS for SMEs

On 22 January, EFRAG launched a public consultation on the Exposure Draft ESRS for listed SMEs (ESRS LSME ED) and the Exposure Draft for the voluntary reporting standard for non-listed SMEs (VSME ED). The purpose of these ESRS is to set reporting requirements that are proportionate and relevant to the scale and complexity of the activities, as well as the capacities and characteristics of SMEs. The consultation is open until 21 May 2024.

EP adopts directive to empower consumers for the green transition

On 17 January, the EP adopted a Directive amending the Consumer Rights Directive and the Unfair Commercial Practices Directive, aiming to empower consumers for the green transition. Complementing the proposed Green Claims Directive, which will apply to businesses, this Directive will provide consumers with improved information and enforcement rights. Firstly, a number of market practices related to greenwashing and the early obsolescence of goods will be added to the list of banned commercial practices. Secondly, general environmental claims like 'environmentally friendly', 'climate-neutral' and 'eco' without proof and other misleading information will be banned. Thirdly, only sustainability labels based on approved certification schemes or established by a public authority will be allowed. Fourthly, guarantee information has to be more visible and a new guarantee extension label will be introduced. The directive is subject to final approval by the Council, after which it will be published in the Official Journal. It will then have to be transposed into national law within 24 months.

ESAs publish consolidated Q&As on the SFDR and Delegated Regulation

On 12 January, the three European Supervisory Authorities (EBA, EIOPA and ESMA – the ESAs) published consolidated Q&As on the SFDR and the SFDR Delegated Regulation. This document combines answers given by the Commission to questions requiring interpretation of Union law under Article 16b(5) of the ESA Regulations, which are color coded in blue, and responses generated by the ESAs relating to the practical application or implementation of SFDR under Article 16b(1) of the ESA Regulations, which are not color coded.

ESAs launch consultation on draft implementing technical standards specifying certain tasks of collection bodies and certain functionalities of the ESAP

On 8 January, the ESAs published a consultation paper on the draft implementing technical standards (ITSs) relating to the tasks of the collection bodies and the functionalities of the European Single Access Point (ESAP). These ITSs and the requirements they set out are designed to enable future users to make effective use of the comprehensive financial and sustainability information centralised on the ESAP. The consultation runs until 8 March 2024.

Litigation

Friends of the Earth Netherlands (Milieudefensie) announces climate case against ING

On 19 January, NGO Friends of the Earth Netherlands (Milieudefensie) announced its intention to initiate a climate case against Dutch bank ING. Milieudefensie demands that ING (i) aligns its climate policy with the 1.5°C target of the Partis Agreement; (ii) reduces its absolute CO_2 emissions by 48% and its CO_2-eq emissions by 43% in 2030 compared to 2019; and (iii) among others, demands a climate plan from its large corporate clients and phases out its financing of the fossil fuel sector. If ING does not concede to these demands within eight weeks, Milieudefensie intends to initiate its climate case. ING published its reaction here.

Norwegian court invalidates impact assessments for three Norwegian oil fields

On 18 January, the Oslo District Court ruled that the impact assessments for three Norwegian oil fields, carried out by the Norwegian Ministry of Energy, are invalid. The court suspended the granting of any new permits required for the further development or operation of the oil fields until a final ruling on the validity of the approval decisions is delivered. The impact assessments were ruled invalid because they did not, or did not sufficiently, address the expected greenhouse gas emissions associated with the oil fields. At this stage, the Court did not establish a violation of Articles 2, 8 or 14 ECHR, as the climate cases at the ECtHR are still pending.

Paris Court of Appeal installs chamber for ESG cases

On 15 January, the Paris Court of Appeal announced the installation of a dedicated chamber within its economic division to deal with cross-disciplinary environmental disputes. In particular, the chamber will handle appeal proceedings relating to the French due diligence law, the CSRD and the CSDDD. The Court states that the installation of this chamber demonstrates the importance it attaches to these cases. The chamber will hear its first cases in the first half of 2024.

Bonaire climate case against the Dutch State

On 11 January, NGO Greenpeace Netherlands and eight residents of the island of Bonaire initiated a collective climate case against the Dutch State. In their writ of summons, the claimants request the District Court of the Hague to, inter alia, order the Dutch State to implement climate mitigation measures, as well as various adaptation measures to protect the inhabitants of Bonaire from the consequences of climate change. The primary mitigation claim requests an order on the Dutch State to reduce its CO_2-eq emissions to net zero by 2030, with any remaining emissions to be compensated by international climate finance.

Do you have any questions or comments on a specific ESG topic? Please do not hesitate to contact our Sustainable Business & Climate Change team. If you or members of your team would also like to receive updates, please sign up.

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Meet the [whole team]

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