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CARBON MATTERS

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

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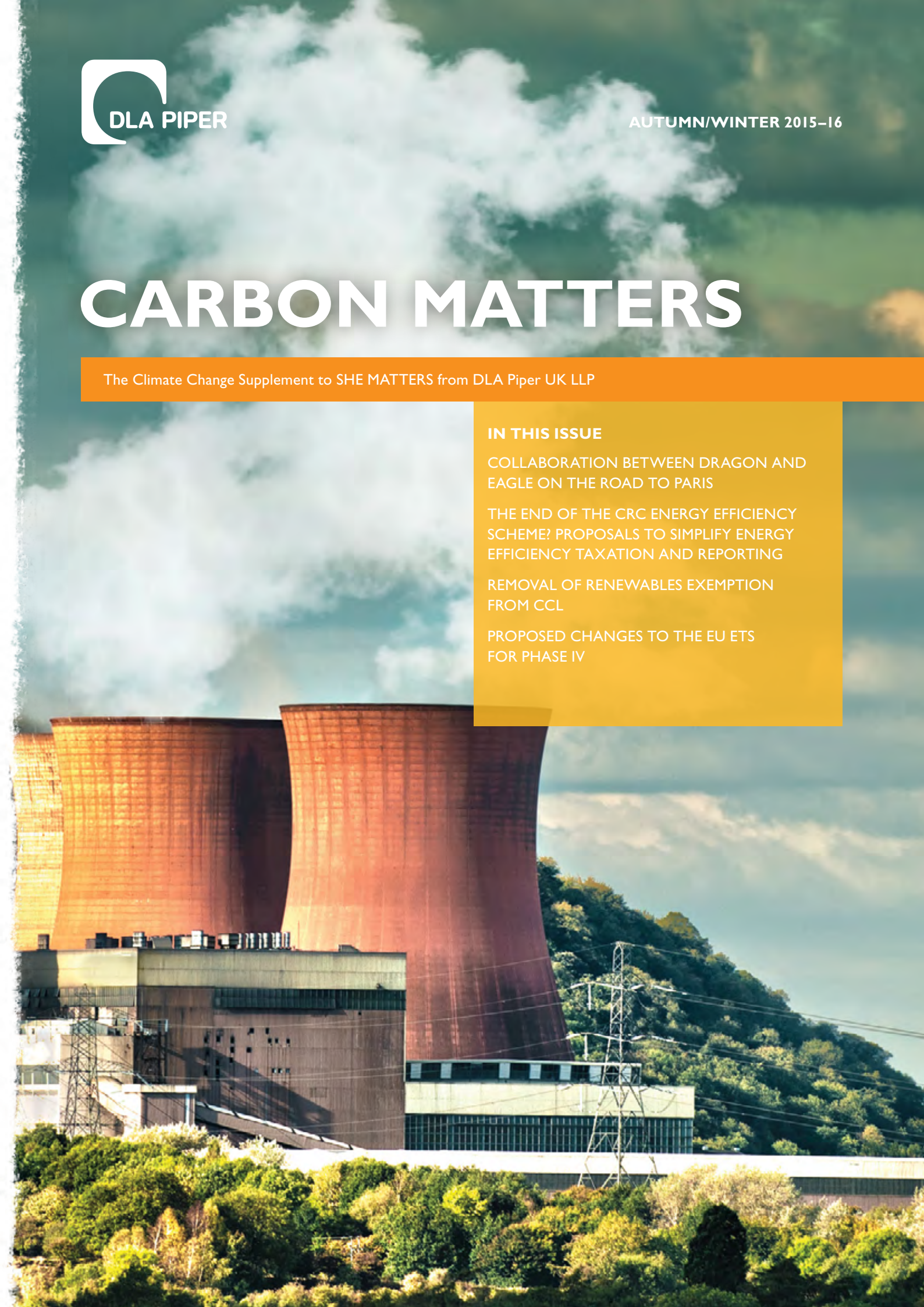

CARBON **MATTERS**

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At the end of November, delegates from 195 countries, and the EU, met at Le Bourget Airport outside Paris, for the 21st Conference of the Parties to the UNFCCC Treaty, and the 11th Meeting of the Parties to the Kyoto Protocol.

On 12 December, the negotiations, which had run on into the weekend, concluded with an agreement. For a detailed summary of that Agreement, prepared by lawyers in our Vienna office who were closely involved in monitoring negotiations at the COPMOP, see our recent client alert. The Agreement, which will be legally binding in international law once signed and ratified by at least 55 countries that account for at least 55% of global greenhouse gas emissions, contains an ambitious goal:

It commits the parties to keeping long-term global warming "well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels".

Those targets are ambitious, and many doubt whether they are realistic, given current and likely future emissions.

However they certainly send a strong political signal that so many countries are prepared to work towards a low carbon economy.

Agreement on the targets was reached in part because while the framework Agreement will be legally binding, the commitments set out in the Intended Nationally Determined Contributions (INDCs), on which the meeting of those targets will largely depend, will not be. The distinction was crucial in obtaining the agreement of the US Government. President Obama is strongly in favour of action on climate change, but faces strong opposition in Congress, and could not risk agreeing to a treaty that would require ratification by the Senate.

188 countries have already signed up to INDCs. On at least one estimate, the commitments in those INDCs currently fall some way short of meeting even the 2°C target. However it is hoped that the review process provided for in the Agreement, and international group pressure, will lead to gradual raising of "ambition" as regards the INDCs, so that the targets can be met.

The COPMOP can be said to have achieved its goal, to produce an agreement which will be legally binding and take effect by 2020 when current commitments under the Kyoto Protocol expire. Indeed the accompanying decision goes further in terms of making significant provision for enhanced action prior to 2020.

COP 21 provided a happy contrast with the 2009 COPMOP in Copenhagen which sought – but failed – to meet a similar goal.

There were significant tensions at the summit but some time in advance there had been a quiet confidence that agreement would be achieved. Why the contrast?

It is clear that the lessons of 2009 COPMOP had been learned.

An important development in advance of the COPMOP was Chinese American Co-operation, discussed in the first article of this issue.

That was supplemented by an accord between China and France in which China agreed to support five-yearly reviews of the INDCs aimed in particular at securing that developing countries "progressively orient themselves towards quantifiable reductions or limitations in emissions".

One argument which had previously hampered negotiations is that developed countries should bear all of the cost and burden because their historic emissions caused the problem in the first place. That argument is being undermined by the increasing wealth of many developing countries and their rapidly increasing share of global emissions. It is China's increasing wealth, despite the recent slowdown, and awareness of the problems caused by rapid industrialisation, which has effected a revolution in China's own approach to the environment. Astonishingly this includes the recent introduction of a new role for NGOs in the enforcement of environmental compliance in that country, and specialist environmental sections in the courts.

It is also evident that France, whose foreign minister, Laurent Fabius, travelled extensively to China in the 18 months preceding the COPMOP and who himself presided at Le Bourget, set considerable store by the success of the COPMOP.

France was clearly determined to avoid the tactical errors of the "top-down" approach adopted by the Danish presidency and other EU delegations at Copenhagen. Emphasis was placed instead on a "bottom up" approach in which agreement would be sought on the basis of what different states had indicated they would be prepared to agree to.

France also made special arrangements for a "civil society village" for NGOs at Le Bourget, in contrast to the treatment they received at the 2009 COPMOP when they were turned out into the cold streets of Copenhagen in winter.

Lastly, the COPMOP can be said to have obtained the support of both God and Mammon. It obtained the blessing of the Pope, whose encyclical Laudato si' seems at least in part to have been issued to encourage progress at the COPMOP. Furthermore CEOs from 78 global companies signed an open letter in advance of the summit, calling on governments to take bold action. The signatories included Sir Nigel Knowles, Global Co-Chairman of DLA Piper. A copy of the open letter is attached.

Open Letter from Global CEOs to World Leaders Urging Concrete Climate Action

CEO-led initiative to create a fertile ground for a responsible and global climate deal in Paris 2015

Climate change is one of the biggest global challenges that will shape the way we do business now and in the coming decades. The United Nations Climate Change Conference of the Parties 21 (COP_{21}), to be held in Paris in December 2015, aims to deliver a new climate change agreement that will put the world on track to a low-carbon, sustainable future while keeping the rise in global temperature to under 2 degrees Celsius.

This coalition, comprising 79 CEOs from companies with operations in over 150 countries and territories, and facilitated by the World Economic Forum, believes the private sector has a responsibility to actively engage in global efforts to reduce greenhouse gas (GHG) emissions, and to help lead the global transition to a low-carbon, climate-resilient economy. This coalition further seeks to catalyze and aggregate action and initiatives from companies from all industry sectors — towards delivering concrete climate solutions and innovations in their practices, operations and policies.

The undersigned, as CEO climate leaders, urge the world's leaders to reach an ambitious climate deal at COP_{21}, aligned with the UN Post-2015 Sustainable Development Goals (SDGs). We extend an open offer to national governments to meet and co-design tangible actions as well as ambitious, effective targets that are appropriate for their different jurisdictions.

Our commitments

- The companies we represent are taking voluntary actions to reduce environmental and carbon footprints, setting targets to reduce our own GHG gas emissions and/or energy consumption while also collaborating in supply chains and at sectoral levels. Technological innovations will be an important element.
- We agree on the need for inspirational and meaningful global action and aligned messaging. We will act as ambassadors for climate action, focusing on solutions and economic opportunities and using "the science debate is over: climate change is real and addressable"* as one of the common themes to raise public awareness.
- We will actively manage climate risks and incorporate them in decision making — not least to realize growth opportunities. We will take steps to implement effective strategies to strengthen not only our companies' but also societal resilience.

Our vision supporting a climate deal

- We believe that effective climate policies have to include explicit or implicit prices on carbon achieved via market mechanisms or coherent legislative measures according to national preferences, which will trigger low-carbon investment and transform current emission patterns at a significant scale. We support global mitigation approaches that promote cost effective incentives for cutting emissions, while respecting level playing fields and preventing carbon leakage.
- We urge a strategic action agenda — supported by clear and consistent policies and robust monitoring, reporting and verification (MRV) — that will complement business efforts to stimulate innovation as well as collaborative actions across value chains, and to develop and scale up alternative and renewable energy sources, promote energy efficiency, end deforestation and accelerate other low-carbon options and technologies such as ICT.
- We welcome transparency and disclosure regarding financial investments and policies in relation to all energy-related activities — including fossil-based and alternative. We support assessments of resilience to climate risks and call for new financial instruments to stimulate alternative energy and efficiency projects as well as green bonds. This will enable climate action to be integrated with financial reporting and instruments.

  For further information on the CEO Climate Leaders and how to join, please contact ceoclimateleaders@weforum.org
- We encourage governments to set science-based global and national targets for the reduction of GHG emissions and the development of alternative energy sources.

Hastening the shift to a low-carbon economy in an economically sustainable manner will generate growth and jobs in both the developing and developed world. Delaying action is not an option — it will be costly and will damage growth prospects in the years to come. The CEO climate leaders call on government leaders and policy makers to align on global measures, to be consistent in policy-making and to develop helpful innovation frameworks.

A comprehensive, inclusive and ambitious climate deal in Paris on mitigation, adaptation and finance — in combination with a strong set of clear policy signals from the world's leaders — is key to accelerating this transition. This opportunity should not be missed.

**We will build on the data provided by the Intergovernmental Panel on Climate Change (IPCC) of the UN, NASA, and the New Climate Economy Report ("Seizing the Global Opportunity") of the Global Commission on the Economy and Climate.*

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COLLABORATION BETWEEN DRAGON AND EAGLE ON THE ROAD TO PARIS

A DISCUSSION OF THE U.S. AND CHINA'S APPROACH TO CLIMATE CHANGE PRIOR TO THE UN CLIMATE CHANGE CONFERENCE IN PARIS

One of the key factors in enabling agreement to be reached at the Paris COPMOP was the preparatory work well in advance of the COPMOP, carried out by the US and China. This helped to avoid a clash at the COPMOP between these two powers, and also provided a clear signal that two of the largest economies in the world agreed on the need for action on climate change.

In 2009, the previous attempt by world leaders to tackle global warming and secure a global treaty limiting greenhouse gas emissions famously came to nothing. In Copenhagen, delegates were not willing to agree a deal that had been drafted 'from the top down', by only a small number of countries without input or contributions from others. Whilst the summit did recognise a need to limit global temperatures to rising no more than 2°C above pre-industrial levels, the proposed deal was not to be legally binding, causing many to question whether it could really have any significant impact. Nevertheless, perhaps the most significant stumbling block was that the US and China were reluctant to sit at the negotiation table.

Historically the U.S. and China were in a regulatory stalemate over climate change. Economic and political rivalry meant that even as two of the world's biggest carbon emitters, neither wanted to regulate their emissions, through fear that the other may take advantage to dominate the world's economy. Consequently, in Copenhagen, China was viewed by many political commentators as being openly uncooperative and, despite being a renowned supporter of green issues and regularly talking to the threats of global warming, President Obama arrived with his hands tied by a reluctant Congress, with healthcare issues in the U.S. being his primary focus and distraction. A drastic change in approach by both nations in the past twelve months, towards a cooperative stance on tackling climate change together, was therefore a promising development and was treated by many as an extremely positive indicator going into Paris.

In November last year, during President Obama's visit to Beijing, the U.S. and China announced their plans to begin a collaboration to cut carbon emissions. At that time, China pledged to make sure its CO_2 emissions peak by 2030 and decrease its reliance on fossil fuels by imposing a target of sourcing 20% of its primary energy consumption from renewables by 2030. As the world's leading investor in renewable energy, China has taken clear steps forward. In turn, the US committed to cutting its CO_2 emissions by 26-28% by 2025, compared to 2005 levels.

Since that first collaboration, both China and the U.S. continued to make progress in the lead up to Paris. During his visit to Alaska in August/September, President Obama told a meeting of foreign ministers from nations with territory in the Arctic that climate change would "define the contours of this century". The President came out in clear support of striking a deal in Paris in December, on the grounds that the climate was changing faster than efforts to combat global warming.

President Xi Jinping's visit to the White House in September this year was the culmination of several months of discussions between US and Chinese officials and saw China pledge to launch a national 'cap-and-trade system' by 2017, expanding pilot programmes that have been rolled out in seven cities and provinces since 2013. The systems work by firstly capping CO_2 emissions and then allowing companies to buy and sell permits that allow them to emit set levels of carbon under the cap. They will cover an extensive range of sectors that produce a significant level of emissions (e.g. steel and cement industries). This announcement was not aimed at altering the target to peak emissions by 2030 that China set last November, but instead goes some way to demonstrating its ability to meet that goal.

In addition to the measures to improve its own emissions, China also promised to make a $3.1 billion contribution to finance efforts to combat climate change in poorer countries. This support followed the $3 billion pledge made by the U.S. last year for the international Green Climate Fund. The real significance of China's input is that in the past highly developed

economies have held the burden of funding lower emissions and measures for adverse weather in poorer countries. In the words of Li Shuo, Greenpeace East Asia senior climate policy analyst, this represented "a drastic increase from China's previous finance commitments".

Given the warning from government researchers that China's low lying coastal areas will be hugely at risk if global temperatures melt ice caps and raise sea levels (sea levels along China's coast are rising faster than the world average), as well as the well-documented levels of air pollution in China's major cities, as well as ground contamination and water pollution, there is a clear incentive behind their increased contribution. While the U.S.'s total emissions fall considerably below those of China, its emissions per-capita are three times greater. By focusing on reducing U.S. carbon dependency, President Obama has real scope to leave a green legacy by the end of his term.

The roll-out of renewables and less carbon-intensive energy can only work if there are sustained price and regulatory signals from governments, coupled with innovations in the market. In this sense, having the world's two biggest economies on board gives these technologies genuine scope to develop. In recent years, since China began its heavy investment into the manufacturing of renewable energies, there has been a marked drop in the cost prices of these alternatives to carbon emitting energy sources, making them genuinely viable alternatives.

However, the real benefit of the U.S. and China's collaboration and increased focus on climate change was that on a global scale it acted as a catalyst for change at Paris. With the Paris accord being drafted from the bottom up, with countries themselves deciding how much they can cut their emissions and change their economies by submitting national climate plans called Intended Nationally Determined Contributions (INDCs), the agreements between the two nations posed direct questions to the other larger polluting nations and encouraged many to follow suit. Indeed, according to the UN, INDC submissions now cover around 86% of global emissions, which is four times the amount covered by the Kyoto Protocol. Furthermore, 105 of the INDCs submitted ahead of Paris contained concrete CO_2 mitigation targets, in contrast to only 27 nations who had these targets in place ahead of Copenhagen. The credibility of the bottom-up system would have been severely compromised were these two nations not to make a sizable contribution.

Despite the rhetoric for a low carbon future and the overwhelming success of engaging nations to submit INDCs, the numbers still don't quite add up to what some scientists say is needed to limit the global temperature increase to 2°C above pre-industrial levels and avoid the worst of global warming. As it stands, emissions are set to continue rising, albeit at a lower rate.

It remains to be seen what effect the process for the revision of INDCs agreed at the COPMOP will have in terms of improving the position.

It is clear, in the words of Mohammed Adow, Christian Aid, that "Paris will not be the end of the world's efforts to tackle climate change, but it might be the end of the beginning".

Chinese American Co-operation nevertheless appears to have been a key focus in making a good stand.

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THE END OF THE CRC ENERGY EFFICIENCY SCHEME?

PROPOSALS TO SIMPLIFY ENERGY EFFICIENCY TAXATION AND REPORTING

Following the announcement made at the time of the Summer Budget of a review of the business energy efficiency tax landscape, HM Treasury has issued a consultation paper which proposes the abolition of the CRC Energy Efficiency Scheme (CRC), and its replacement by a single business energy consumption tax based on Climate Change Levy (CCL). The review will also take into consideration the Enhanced Capital Allowances currently available for specific energy efficiency and low carbon technologies and the Electricity Demand Reduction Fund currently being tried out as a pilot.

The Government also proposes to develop a single reporting framework to replace current requirements under ESOS, Mandatory Greenhouse Gas Reporting and other schemes including the CRC scheme and the Climate Change Agreements. It is proposed to design this framework "through the prism of" ESOS, a scheme which the Government is committed to maintain, because it is an EU requirement under the Energy Efficiency Directive.

The Government argues that over the last 15 years a number of different policy instruments have been introduced to encourage the uptake of energy efficiency and low carbon measures. However, this has resulted in a complex regulatory landscape, which often requires businesses to report emissions and energy consumption a number of different times and in different contexts, and subjects businesses to strikingly different tax rates on different sites, activities and fuels.

It is argued that these complex requirements may actively discourage investment in energy efficiency and decarbonisation.

To address this, the consultation paper sets the review a number of objectives:

- Consistency with fiscal consolidation plans. (This is presumably a coded statement that the overall tax burden to business cannot be allowed to decrease, and thus adversely affect public finances).
- The simplification and reduction of compliance and administrative costs.
- The protection of energy intensive businesses at risk of carbon leakage.
- The support of productivity through improving incentives for energy efficiency and carbon reduction.

It is also implicit in the consultation paper that any changes proposed must be consistent with EU obligations such as those under the Energy Tax Directive.

Since that Directive is the main driver behind CCL, it is not surprising that the proposal for a new business energy consumption tax which would take over the revenue raising element of the CRC should be based on CCL. However, the Government has indicated that it is open to views as to the balance of tax costs across fuels, where proposals can deliver carbon reduction potential. The Government is also open to the suggestion that smaller business consumers and Energy Intensive Industries at risk of international competition from industries not subject to such taxation should pay lower rates.

There is some suggestion that the current exemption from CCL for energy used in mineralogical and metallurgical processes would continue under the new tax, and that the equivalent of Climate Change Agreements (CCAs**)** within the new tax should focus on Energy Intensive Industries which are exposed to international competition and the risk of carbon leakage. Parties in eligible industry sectors which have signed up to CCAs currently obtain substantial discounts from the different rates of CCL, and sites where over 70% of the energy consumed is covered by a CCA are exempt from the CRC.

The Government has also indicated but it is "*open to considering"* options for new incentives for energy efficiency. These would need to comply with the Energy Tax Directive and may need state aid clearance. They would also need to be funded so as to avoid any adverse impact on deficit reduction targets. Presumably any new incentives would therefore need to be paid for by a corresponding general increase in the new business energy consumption tax.

The consultation paper also notes that the proposal to merge the CRC scheme and the CCL into a single energy consumption tax based on the CCL would exclude the public sector and the non-business activities of charities from a price signal, and reporting obligations, that may drive energy and emissions savings.

The Paper therefore canvasses the idea that the merged tax might be "*designed to improve its effectiveness in driving energy and carbon savings from the public sector and charities*".

It also suggests that the proposed new reporting framework might also require reporting by the public sector.

It seems likely that there will be mixed reactions to the Consultation Paper. Undoubtedly many businesses will welcome the proposed demise of the CRC, which has proved to be costly and burdensome, even though it was originally intended to have a light "regulatory touch". There are many who take the view that the need to comply with the scheme did bring to light potential energy savings which businesses had not previously considered. However, it may well be that the benefits of that will not be entirely lost if the CRC is replaced by a new tax, which is likely to be significant less costly to administer.

The CRC has the inevitable administrative complexities of an emissions trading system, but without revenue recycling, few of the potential benefits, and the consultation paper is indeed fairly candid in viewing it essentially as a tax.

The advantages of modelling a new tax on the CCL is that both the burdens and the incentive effect of that tax could be spread more widely.

The advantage to business of the proposed simplification will of course to some extent be offset by the need to understand and in due course implement the new regulatory requirements of the proposed new tax and reporting regimes.

It is likely however that, assuming the proposals are carried further, they will take a significant period of time to come into force.

The review is at a very early stage, and the consultation is very much an "*outline*" consultation. That will enable stakeholders to exert significant influence on the detail of the proposals.

Expressions of view from interested parties are invited by 9 November and the Government proposes to follow up with further communication and discussions with interested groups.

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REMOVAL OF RENEWABLES EXEMPTION FROM CCL

The Climate Change Levy is a carbon tax that is added to the energy bills of business and public sectors organisations. It was introduced on 1 April 2001 and typically adds approximately 15% onto those energy bills.

There are a number of exemptions from the levy which means that it is not payable when, for example, the energy derives from a particular source. Once such exemption relates to electricity generated from qualifying renewable sources.

In the Chancellor's budget speech on 8 July 2015, George Osborne confirmed that this exemption was to be removed with effect from 1 August 2015 which meant that the levy would for the first time become payable on energy generated from renewable sources.

The Government's rationale for this was that this particular exemption was no longer required because since it has been introduced more effective national policies have been implemented to support renewable energy generation. The Government also took the view that the suggested change would simplify and stabilise the levy.

REMOVAL OF THE EXEMPTION

Legislation was contained in the Summer Finance Bill 2015, which is currently going through the Houses of Parliament and Commons, to amend the Finance Act 2000 to adjust the exemption such that electricity generated from renewable sources on or after 1 August 2015 will not benefit from the exemption.

The legislation allows utility companies to accumulate renewable source electricity and renewable levy exemption certificates. To the extent that these have been generated prior to 31 July 2015 it will still be possible to supply electricity exempt from the levy for a transitional period which is still to be determined.

This apportionment of electricity from renewable energy sources and supplied before and after 1 August 2015 will therefore need to be factored into Climate Change Levy tax returns submitted at the end of the 2015/2016 tax year.

IMPACT OF REMOVING THE EXEMPTION

Predictably, the Government took the view that this change would not impact on wholesale electricity prices or that it would increase energy bills as the energy market is a competitive market.

However, it is difficult to see how this change will not have a significant impact on some businesses.

For example, we know that clients who generate electricity from renewable sources are almost certainly going to be affected. Up until now, if biomass was used as a fuel source then it would mean that the operator/purchaser of the biomass would not have to pay the climate change levy. As a result of the Chancellor's plans those operators will now have to either pay the levy or, if eligible, enter in to a climate change agreement which requires energy use reductions in return for a subsided levy.

For those operators who pay the levy then their costs will automatically rise because the proportion of their energy supply which comes from renewable sources will now become subject to the levy. This was demonstrated very clearly by the sharp drop in the share price of the Company which operates Drax power station immediately following the Chancellor's speech. This resulted in a £425 million reduction in the company's value which has been attributed directly to the increased costs as a result of the removal of the levy.

Interestingly, Drax announced at the end of September that it would not be renewing funding for an existing carbon capture and storage research project which was looking into the potential to capture up to 90% of carbon emissions from a new coal fired power station and store them beneath the ocean.

We do not know why the Company has withdrawn this funding. However, it does seem to be a coincidence that shortly after the Government decides to remove an exemption from the climate change levy which will increase the Company's operating costs that the Company withdraws funding for a project which sought to identify ways of safely managing emissions from power plants.

This appears to be at least one example of where the Government's change in policy has had a negative impact on other emission reduction measures and we are sure that there will be others.

There is little that we can do about the removal of the exemption but clients need to be aware of the change and to plan for its impact.

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PROPOSED CHANGES TO **THE EU ETS FOR PHASE IV**

In July, the EU Commission published, as part of a "Summer Energy Package", a Draft Directive to introduce changes to the EU ETS for Phase IV, which will run from 2021 to 2030.

The changes proposed for Phase IV include:

- A more rapid reduction (2.2 per cent per annum, instead of 1.74 per cent per annum) in the overall cap on allowances under the scheme (EUAs).
- Revision to the system of allocation of free allowances to reflect the tightening overall cap on EUAs. (Free allocation will focus on sectors at the highest risk of carbon leakage. Benchmark values are to be updated (i.e. reduced) in the light of advances in technology, and there will be a better reflection of changes in production, with allocation decisions being made for five years instead of eight, and there being provision for increased free allocation of EUAs if production increases where there is no increase in capacity).
- There will be a larger New Entrants Reserve, which will include unallocated Phase III EUAs from the Market Stability Reserve currently being introduced into the Scheme.
- The option for Member States to exclude small emitters from the scheme will be continued.
- A new Modernization Fund to support transition to low-carbon technologies in Central and Eastern Europe and an Innovation Fund to finance R&D for new low-carbon technologies for the generating and relevant industrial sectors.
- A broadening of the range of purposes which qualify for meeting Member States' obligation to spend 50 per cent of their EUA auction revenues, so as to include climate finance for vulnerable third countries, indirect carbon costs, and the development of skills for a decarbonising economy.

The UK Government has recently responded, broadly welcoming the proposals, but has called for provision for support for Sectors at risk of Carbon Leakage to vary according to the degree of risk of such Leakage.

The Government is also concerned that proposals for a reduction in benchmark values may not reflect genuine technological improvements, and could cause competitive distortion between sectors.

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