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Regulatory Update

The EU Taxonomy – Why?

By [Ruth Knox](#)

The European Union Taxonomy¹ emerged in May 2018 as a classification system to determine whether businesses are environmentally sustainable. Using a prescriptive, technical, linear approach to assessing the eligibility of a business for the EU's deepest green badge, it followed the legalistic style of the French Civil Code, and flummoxed non-European sponsors when tasked with a detailed evaluation of portfolio investments with European environmental law and international human rights principles. And yet, the EU has stayed wedded to the ideal presented by these highly nuanced and demanding technical standards, as further evidenced by its role in the recent Omnibus Proposals. This white paper provides readers with an update on the latest status of the EU Taxonomy, its likely centrality within the future EU sustainable finance agenda and an articulation of why sponsors of any origin should begin sharpening their pencils to push investees to align with its criteria.

What does it mean to align with the EU Taxonomy?

The EU Taxonomy Regulation stipulates that a business activity shall qualify as environmentally sustainable where:

1. it contributes substantially to an environmental objective;
2. does no significant harm to any environmental objectives; and
3. adheres to the minimum safeguards.²

The “*contribution*” to an environmental objective and assessment of “*significant harm*” are both determined by reference to technical criteria that are essentially detailed write-outs of EU environmental legal requirements that have emerged over the past 20 years in respect of the collection of business activities that the EU deems sufficiently “*green*” for inclusion in the EU Taxonomy. There are also purely technical criteria, such as the carbon intensity of electricity generation for certain power installations.

Contrasting with the environmental legal and technical criteria of the first two parts of EU Taxonomy alignment, the third critical element (which is often ignored or assessed in a second- rate manner) requires a principles-based review of whether and how the practices, processes and procedures are adopted and live within each business on (1) the protections and respect for human rights, employee rights, and anti-bribery and anti-corruption laws and (2) the existence of a robust grievance mechanism to remedy breaches. It is not a check-the-box exercise; rather it requires a sensitive and context-specific review of the business against the backdrop of its sector(s) and geography of operation, size, scale, resources and history.

How do we even think about alignment?

How does a sponsor or portfolio company even start to get to grips with this tome of highly technical requirements?

Before any business can think about alignment, it must consider whether it is even eligible for the EU's greenest badge. This takes us back to the list that comprises the EU Taxonomy itself, beginning with reviewing the table of contents in each of the delegated acts to see if the relevant business activity is even included. This list has been added to in recent years, with such controversial additions as advanced technologies to produce energy from nuclear processes and electricity generation from fossil gaseous fuels. While the list has been subject to challenges by non-governmental organisations, no challenge has been successful to date, and there are clear messages that the list will become longer and broader over time, to include business activities such as mining and manufacturing of metals.³

Once you have determined eligibility, you then begin to work with the portfolio company to determine whether their business activity meets the special blend of environmental legal and technical requirements. This can be done primarily with environmental lawyers, although technical environmental engineering expertise will also be necessary for assessment of the pure technical aspects.

Following the environmental assessment, the human rights lawyers step in. This involves the careful development of company-specific questions which determine whether the business aligns with the key principles of protect, respect and remedy under the applicable UN and OECD frameworks.

What was said in the Omnibus package on the future of the EU Taxonomy?

In February 2025, the European Commission (the Commission) announced a raft of changes to the EU Taxonomy as part of its Omnibus package which is gearing the EU up for a simplification of sustainability reporting with a view to enabling a stronger, more competitive European economy.

The proposed changes include:

1. Limiting reporting obligations to the largest companies corresponding to the scope of the Corporate Sustainability Reporting Directive (CSRD) (i.e., 1,000 employees and a turnover/revenue of over €450 million).⁴
2. A financial materiality threshold which would exclude disclosure for companies with less than 10% eligible business activities.
3. Permission for businesses to leave out reporting on the alignment of operational expenditure if the cumulative turnover of their eligible business activities does not exceed 25% of their total turnover.
4. The creation of a new category of "*partial alignment*", which could facilitate alignment by so-called "*transition*" investments.
5. Simplification of reporting templates for those businesses that are caught by mandatory EU Taxonomy-alignment reporting, including a potential reduction in the number of technical data points by around 70%.
6. The exclusion, in their Taxonomy alignment reporting, of exposure to companies that have more than 1,000 employees and are indirectly subject to Taxonomy reporting (except for large undertakings), in order to facilitate accurate reporting by banks.

Interestingly, the Commission notes in the explanatory memorandum to its draft delegated act on the simplification of the EU Taxonomy that:

“Do no significant harm criteria are considered often overly complex and burdensome and undertakings often quote the difficulty to establish compliance with those criteria as the main reason for absence of Taxonomy-alignment.”

This is why, for determining alignment of business activities such as the manufacturing of solar photovoltaic (PV) batteries and heat pumps (all recognised by the Commission as “critical for the green transition”), the Commission proposes to lighten the criteria for (amongst others) pollution, prevention and control regarding the use and presence of chemicals. The Commission may also remove or replace requirements that substances used are not carcinogenic, mutagenic, bio-accumulative and toxic, which could encourage more SMEs to begin reporting, making them more likely to qualify as sustainable investments. Such businesses may, as a result, become more attractive to lenders aiming to improve their “green asset ratios”, which are mandatory Taxonomy-alignment disclosures required by separate EU regulatory requirements governing the banks. This may in turn facilitate lending to general partnerships (GPs) as part of acquisitions, broadening the pool of potential investees where GP strategies seek sustainable investments.

The proposed rules are set to apply, in their amended form, from 1 January 2026.

Why must we begin to align investee companies with the EU Taxonomy?

Because of the detailed and prescriptive nature of the EU Taxonomy, and its foundation in EU environmental law and international human rights principles, the European institutions firmly believe that reliance on the EU Taxonomy helps prevent greenwashing by objectively informing investors about companies’ alignment with sustainability criteria.⁵

In addition to the prevention of greenwashing, the EU also firmly believes that the EU Taxonomy enables the flow of capital towards environmentally sustainable activities and projects. The recently published paper by the EU’s Platform on Sustainable Finance (PSF)⁶ on monitoring capital flows to sustainable investments notes that, most relevantly for sponsors, a quarter of Taxonomy-aligned investments forming part of their review⁷ were in the manufacturing sector and 76% of capex in the utilities sector (electricity, gas, steam and air conditioning supply) is Taxonomy-aligned. The adherence to the dark green badge is growing.

Of course, it isn’t enough of a reason to align, that a transnational regulator believes in the power of its own regulatory prowess to determine what is factually sustainable. More interestingly, EU-headquartered limited partnerships are beginning to grasp the data with real appetite as they in turn report to their own stakeholders, which include the asset management arms of investment banks that are subject to the “green asset ratio” reporting requirements. Furthermore, we note the PSF’s proposal for the categorisation of products under the Sustainable Finance Disclosure Regulation⁸ which, although not binding, is (highly) indicative of the future decisions that may be taken by the Commission with respect to the SFDR. Specifically, the PSF recommends the establishment of a new “sustainable” category which comprises Taxonomy-aligned Investments or Sustainable Investments (SI) with no significant harmful activities, or assets based on a more concise definition **consistent with the EU Taxonomy**, i.e., with clear screening criteria and metrics. As such, the EU Taxonomy will likely have a central role in the labelling of sustainable investments, which in their current form, have grown moderately in popularity over the years with material commitment sizes being offered for them whether as part of pure play Article 9, or so-called Article 8+ funds.

The plan to introduce a new category of *partial* alignment has also been identified as a nod to the widespread call on institutions to enable transition finance to flow more freely within the limits of the EU Taxonomy’s highly prescriptive requirements.

This new flexibility, coupled with the demonstrable willingness by the EU to implement feedback on the usability⁹ of its golden green standard should serve as a comfort to those seeking to align with the criteria.

Over time, capital will flow more easily to those GPs that have grasped the nettle and begun to work with portfolio companies to align with the (hopefully reduced) technical requirements of the EU Taxonomy.

It is here to stay. Seek advice and grasp the commercial opportunity that is before you.

Useful reference materials

[Taxonomy Delegated Acts – amendments to make reporting simpler and more cost-effective for companies](#)

[Platform on Sustainable Finance report: Monitoring capital flows to sustainable investments](#)

[EU Technical Expert Group on Sustainable Finance, Financing a Sustainable European Economy, Final Report of the Technical Expert Group on Sustainable Finance, March 2020](#)

[Commission Notice \(C/2023/267\) on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act establishing technical screening criteria for economic activities that contribute substantially to climate change mitigation or climate change adaptation and do no significant harm to other environmental objectives](#)

[Draft Commission Notice on the interpretation and implementation of certain legal provisions of the Disclosures Delegated Act under Article 8 of the EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets](#)

[Commission Notice \(2023/C211/01\) on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation](#)

[Consolidated Q&A on the SFDR \(Regulation \(EU\) 2019/2088\) and the SFDR Delegated Regulation \(Commission Delegated Regulation \(EU\) 2022/1288\)](#)

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings London lawyer:

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¹ As enshrined in (1) Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, (2) Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives, (3) Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities, (4) Commission Delegated Regulation (EU) 2023/2486 of 27 June 2023 supplementing Regulation (EU) 2020/852 by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution, prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes

no significant harm to any of the other environmental objectives and amending Commission Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities.

- ² The “minimum safeguards” are due diligence and remedy procedures implemented by a company that is carrying out a business in order to ensure alignment with both the Organisation for Economic Co-Operation and Development (OECD) Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.
- ³ [Advisers propose EU taxonomy criteria for mining of metals :: Environmental Finance](#)
- ⁴ See our separate note on the proposed changes to the CSRD – [“The EU Omnibus – But Where Does it Go?”](#)
- ⁵ Draft Commission Delegated Regulation (EU) [] amending Commission Delegated Regulation (EU) 2021/2178 as regards the simplification of the content and presentation of information to be disclosed concerning environmentally sustainable activities and Commission Delegated Regulations (EU) 2021/2139 and (EU) 2023/2486 as regards the simplification of certain technical screening criteria for determining whether economic activities cause no significant harm to environmental objectives, at page 3. The consultation closed for feedback on 26 March 2025.
- ⁶ The successor body to the Technical Expert Group, which created the EU Taxonomy back in 2018.
- ⁷ The PSF reviewed EU entities reporting across multiple sectors pursuant to the Non-Financial Reporting Directive, as of October 2024.
- ⁸ Categorisation of Products under the SFDR: Proposal of the Platform on Sustainable Finance, December 2024.
- ⁹ The explanatory memorandum to the Draft Commission Delegated Regulation notes that the Commission will “*assess the existing criteria from the point of view of their clarity, the availability of evidence to demonstrate compliance, the cost of gathering the evidence and the applicability of the criteria in the international context, and simplify wherever possible.*”