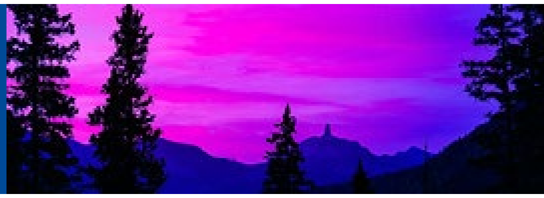

# The Climate Report

## REGULATORY ISSUES & UPDATES

### California Enacts Sweeping Climate Measures

On September 16, 2022, California Governor Gavin Newsom signed a broad legislative package into law that aims to aggressively address climate change. The material aspects of each of these new measures is discussed below.

**Assembly Bill ("AB") 1279**
AB 1279 codifies California's statewide carbon neutrality goal. The measure requires statewide carbon neutrality "as soon as possible," but no later than 2045, and to achieve and maintain net negative greenhouse gas emissions ("GHG"). In addition, AB 1279 requires a reduction in California's anthropogenic GHG emissions to at least 85% below 1990 levels. The California Air Resource Board ("CARB") is tasked with ensuring that its scoping plan identifies and recommends measures to achieve these goals, such as by encouraging carbon dioxide removal technologies to complement emission reductions.

**Senate Bill ("SB") 1020**
SB 1020 codifies into law that renewable energy and zero-carbon resources supply 90% of all retail sales of electricity to California end-users by 2035, 95% by 2040, and 100% by 2045.

**SB 905**
SB 905 requires CARB to establish a "Carbon Capture, Removal, Utilization, and Storage Program" to evaluate the efficacy, safety, and viability of carbon capture, utilization, or storage ("CCUS") technologies and carbon dioxide removal ("CDR") technologies. The bill instructs CARB to establish a clear regulatory framework for these technologies and bans their use for enhanced oil recovery as well as prohibits the practice of injecting carbon dioxide obtained through these technologies into wells for enhanced oil recovery.

**AB 1757**
AB 1757 requires the California Natural Resources Agency ("NRA"), in collaboration with other agencies, to determine a range of targets for carbon sequestration and emissions reductions on natural and "working lands" (i.e., lands used for farming, grazing, or the production of forest products) for 2030, 2038, and 2045. The NRA must also establish an expert committee to advise state agencies on modeling and implementation of natural sequestration projects to ensure that the projects are rigorously vetted. Lastly, CARB is required to develop standard methods for state agencies to track GHG emissions and reductions and carbon sequestration by January 1, 2025.

Given the numerous new regulations that will need to be proposed to support this ambitious legislative package, companies should monitor notices of proposed rulemakings carefully and submit comments to preserve challenges going forward.

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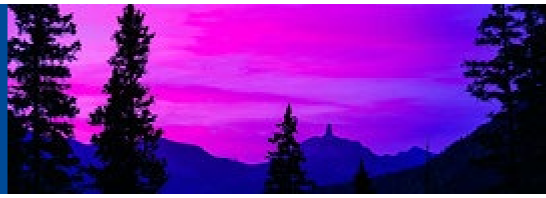

The Climate Report

**REGULATORY ISSUES & UPDATES**

## New Legislation Shaping Australia's Emissions Reduction Policy

On September 15, 2022, significant climate change legislation came into force in Australia with the commencement of the *Climate Change Act 2022* (Cth) and the *Climate Change (Consequential Amendments) Act 2022* (Cth). The new legislation enshrines Australia's emissions reduction targets of 43% on 2005 levels by 2030 and net zero by 2050 (together, the "Targets"). The new laws are an important component of the new Australian government's emissions reduction and renewable energy transition plan. The legislation requires greater transparency and accountability by the Australian government in monitoring and disclosing Australia's progress towards meeting the Targets. It also imposes obligations on Commonwealth government agencies and departments to take the Targets into account when exercising certain powers and functions. The new legislation sets Australia on a course for rapid and far-reaching policy and legislative reforms across all sectors in order to meet the Targets. See Jones Day's recent *Commentary,* New Legislation Shaping Australia's Emissions Reduction Policy, for additional information.

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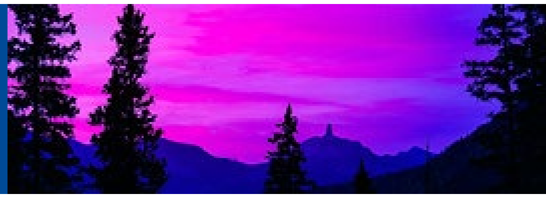

## The Climate Report

**REGULATORY ISSUES & UPDATES**

### The Carbon Takeback Obligation—A Proposal for Reaching Net Zero

Researchers from Oxford Net Zero, a University of Oxford interdisciplinary research initiative dedicated to climate neutrality, and other climate-focused organizations, have proposed a policy mechanism to combat climate change. The Carbon Takeback Obligation, which is gaining traction across Europe, would require fossil fuel producers to permanently sequester a percentage of the carbon dioxide ("$CO_2$") generated by their products.

**Background**

The Paris Agreement establishes a global framework to combat climate change by limiting global warming to below 2°C above pre-industrial levels and pursuing efforts to further limit that number to 1.5°C. However, to successfully limit the increase of global warming at this level, greenhouse gas emissions need to be reduced to net zero by 2050. One critical technology in reducing greenhouse gas emissions is Carbon Capture and Storage ("CCS"). CCS captures $CO_2$ at the source by separating $CO_2$ from other gases and compressing it; the compressed $CO_2$ is then injected deep underground, safely sequestering the $CO_2$ and preventing its entry into the atmosphere. Ideally, CCS would be utilized to capture and store one ton of $CO_2$ for every ton generated.

**The Proposal**

Extractors and importers of fossil fuels would be obligated to permanently store, or "take back," a percentage of the $CO_2$ generated by the products they sell. The Carbon Takeback Obligation would increase incrementally over time. Oxford Net Zero suggests the obligation could start at 1% in 2023 before increasing to 10% in 2030 and reaching 100%, meaning net zero, by 2050. Proponents of this idea believe it is a viable pathway towards net zero that will accelerate adoption of CCS by key industry players.

**Increased Traction**

The idea was proposed as an amendment to the UK's 2015 energy bill but was ultimately rejected due to opposition from lobby groups. The suggestion of a Carbon Takeback Obligation has been recently considered in a UK government consultation on engineered greenhouse gas removals. The consultation closed on September 27, 2022. At the time of writing this article, the findings have yet to be published; one suggestion considered was the development of a compliance market whereby emitters from certain sectors would be required to purchase negative emission credits to compensate for their remaining emissions. Failing to either comply with their takeback obligation or to purchase sufficient credits would cause emitters to incur a penalty for each remaining ton of $CO_{2.}$ Enforcing the "polluter pays" principle in this way would, according to supporters, encourage competition, drive efficiency, and relieve the burden on the taxpayer.

The Carbon Takeback Obligation is certainly not without its critics. Some argue that it is simply a license to continue extracting fossil fuels rather than investing in renewable alternatives. Others argue that the hurdles to implementing such a scheme are too great and that the associated costs would ultimately be borne by the consumers.

Support for a Carbon Takeback Obligation continues to gain traction, however. The Dutch government recently commissioned a feasibility report to understand the viability of imposing such an obligation on the Dutch oil and gas sector. And in the UK, short-lived prime minister Liz Truss confirmed the government's intention to issue further licenses for oil and gas extraction in the North Sea, and the new prime minister, Rishi Sunak, has not yet reversed this. Without accelerating the adoption of CCS, it may be difficult for the government to reconcile increased fossil fuel extraction with its commitment to achieving net zero by 2050.

More generally, the concept of CCS is experiencing a fresh wave of political and industrial support. ExxonMobil recently proposed a large-scale CCS project in the Houston Ship Channel and the United States Congress is set to invest billions of dollars in CCS through tax incentives contained in the Inflation Reduction Act. A Carbon Takeback Obligation may further push CCS into the foreground.

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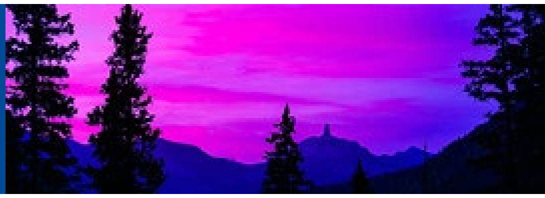
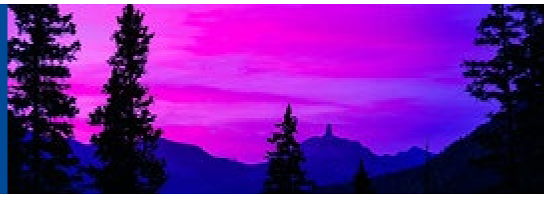


The Climate Report

REGULATORY ISSUES & UPDATES

## U.S. Senators Urge CFTC to Regulate Carbon Credit Markets

On October 13, 2022, seven U.S. senators sent a letter to the U.S. Commodity Futures Trading Commission ("CFTC"), expressing concerns with the integrity of the carbon credit markets and urging the CFTC to investigate and regulate voluntary carbon offsets markets. See Jones Day's recent *Alert*, Senators Urge CFTC to Regulate Carbon Credit Markets, for more details.



The Climate Report

**LITIGATION ISSUES & UPDATES**

## Wave of Climate-Related Actions by First Nations Peoples in Australia and the Torres Strait Islands

Three recent actions highlight an emerging trend of First Nations peoples bringing climate-related claims. Recent decisions in two of these actions have set significant precedents both in Australia and internationally. The third matter is a class action that is scheduled for hearing before the Federal Court of Australia in the second half of 2023, which also has the potential to set a significant precedent going forward. The matters demonstrate a high degree of sophistication and collaboration among interest groups globally in invoking court processes and public international law mechanisms to agitate climate-related issues.

### Torres Strait Islanders' Complaint Upheld by the United Nations Human Rights Committee

First, in September 2022, the United Nations Human Rights Committee ("UNHRC" or the "Committee") upheld a joint complaint filed by several Australian nationals and their children, who are all indigenous inhabitants of islands in Australia's Torres Strait. The Committee found that Australia's failure to adequately protect against climate-related impacts violated the Torres Strait Islanders' rights to enjoy their culture and to be free from arbitrary interference with privacy, family, and home under Articles 27 and 17, respectively, of the *International Covenant on Civil and Political Rights*. The Committee also concluded that Australia's prior commitment to construct protective infrastructure in the region, which is comprised of low-lying islands, was inadequate.

As remedies, the Committee asked Australia, among other things, to compensate the complainants for the harm suffered; engage in meaningful consultation with the affected communities to assess needs; implement all necessary measures to secure the communities' safe existence on their islands; and take steps to prevent similar violations in the future. While the decision is non-binding under Australian law, the Committee has asked Australia to report to the UNHRC, in six months' time, the measures it has taken to give effect to the Committee's views.

This is a landmark decision as it comprises the first instance of an international body finding that a nation state has violated international human rights law through inadequate climate-related adaptation measures. The decision also marks the first time that First Nations peoples' right to culture has been found to be at risk from climate impacts. The decision is likely to pave the way for other similar human rights complaints and actions globally and in Australia. (It is notable in this regard that the complainants were represented by ClientEarth, a global environmental organization). In particular, the decision is likely to be of Torres Strait Islanders' significance in jurisdictions where human rights legislation is in force (in Australia this includes Queensland, Victoria, and the Australian Capital Territory). It may also influence the manner in which stakeholders, including activist investors and regulators, assess corporate performance against voluntary commitments to comply with human rights principles such as those set out in the *United Nations Guiding Principles on Business and Human Rights*.

### Federal Court Sets Aside Approval of an Offshore Gas Field Due to Insufficient Evidence of Consultation with Traditional Owners

The second matter involves a recent decision of the Federal Court of Australia in which a leader of the Munupi clan of the Tiwi Islands, Dennis Tipakalippa, succeeded in a judicial review application, to set aside a decision of the National Offshore Petroleum Safety and Environmental Management Authority ("NOPSEMA") to accept the environment plan of an Australian oil and gas company to drill eight offshore wells in the Barossa gas field.

Under the *Offshore Petroleum and Greenhouse Gas Storage (Environment) Regulations 2009* (Cth) (the "Regulations"), NOPSEMA's acceptance of an environment plan is contingent upon it being reasonably satisfied that the environment plan meets certain criteria. Such criteria includes that the titleholder has carried out consultations with each relevant person whose functions, interests, or activities may be affected by the activities to be carried out under the plan.

The Munupi clan are the traditional owners of land situated closest to the offshore gas field. Mr. Tipakalippa claimed that the clan has "sea country" in and around the proposed drilling site based on traditional hunting activities and spiritual connections; and further, that the project would damage the well-being of the clan and the surrounding environment. Mr. Tipakalippa challenged NOPSEMA's decision on the basis that Santos NA Barossa Pty Ltd ("Santos") had failed to adequately consult Munupi clan members.

Federal Court Justice Mordecai Bromberg accepted that the Munupi clan, as the traditional owners of land proximate to the offshore operation, were relevant people for the purpose of the consultation requirement. The court concluded that Santos provided insufficient evidence to demonstrate that it had consulted with the clan or that NOPSEMA had understood that consultation had occurred.

In the circumstances, the court found that NOPSEMA was not lawfully satisfied that the environmental plan met the necessary criteria for acceptance set forth in the regulations and held that the approval was legally invalid and must be set aside.

Santos' appeal against the decision (*Tipakalippa v National Offshore Petroleum Safety and Environmental* Management *Authority (No 2)* [2022] FCA 1121) before the full court of the federal court has been expedited. Mr. Tipakalippa is represented by the Environmental Defenders Office.

Interestingly, Mr. Tipakalippa's claim followed an action that was commenced in the Seoul Central District Court by other leaders of indigenous Tiwi Islander and Larrakia peoples (one of whom is a Korean citizen) seeking to injunct Korea's export credit agencies, Korea Trade Insurance Corporation ("K-SURE") and the Export-Import Bank of Korea ("KEXIM"), from financing Santos' joint venture partner, SK E&S's, investment in the Barossa gas field project. The claim invoked the environmental protections set forth in Article 35 of the Korean Constitution, along with Article 100 of the *National Finance Act*, which permits citizens to demand corrective measures against unlawful spending of public funds.

While the action was rejected by the court in May 2022, it reportedly led to KEXIM delaying its decision to fund a US $330M credit facility for the project. The action was supported by Solutions for our Climate ("SFOC"), a South Korean-based non-government organization. SFOC, together with Australian-based non-government organizations ("NGO"s), Environment Centre NT and Jubilee Australia Research Centre, formed the Stop Barossa Gas Campaign, which has worked with Tiwi Islands and the Larrakia people in bringing their claims.

**Torres Strait Islander Class Action**

Lastly, the impacts of climate change on the environment and indigenous way of life are also before the federal court in a class action bought by traditional owners from Guda Maluyligal on behalf of all people of Torres Strait Islander descent against the Australian government: *Pabai Pabai & Anor v Commonwealth of Australia*.

The specific question to be considered by the court is whether the government owes a duty of care to Torres Strait Islanders to take reasonable steps to protect them, their culture and traditional way of life, and their environment from climate-related harms. The applicants allege the government breached this duty by, among other things, negligently failing to commit to an emissions reduction target consistent with the "best available science" and to implement measures to reduce emissions consistent with that target; and failing to provide adequate infrastructure to ameliorate physical climate-related impacts in the Torres Straits.

The matter is scheduled for hearing in mid-to-late 2023. The case has been developed with the Urgenda Foundation, which in 2015 brought the landmark case of *Urgenda v State of the Netherlands,* which mandated that the Netherlands government set more ambitious greenhouse gas emissions targets.

The class action follows a decision of the full court of the federal court in *Minister for the Environment v Sharma* [2022] FCAFC 35 in March 2022 which held that the Commonwealth Minister for the Environment does not owe a duty of care to children in Australia to protect them from the physical harms of climate change when assessing environmental approvals for fossil fuel projects. However, the Torres Strait Islanders' argument for a duty of care can be distinguished from that raised in *Sharma* in a number of ways, including that it arises under the *Torres Strait Treaty* which came into force in 1985.

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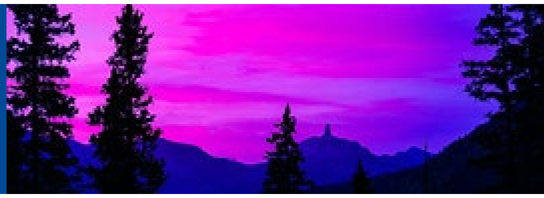

# The Climate Report

## LITIGATION ISSUES & UPDATES

### European NGOs Challenge the Inclusion of Natural Gas and Nuclear Energy in the Taxonomy Regulation

As indicated in the previous edition of the Climate Report, on July 15, 2022, the *European Union Official Journal* published Commission Delegated Regulation (EU) of March 9, 2022. This new delegated regulation includes nuclear energy as well as natural gas, under stringent technical criteria, in the European taxonomy set out by Regulation (EU) 2020/852 of June 18, 2020 (the "Taxonomy Regulation").

On September 19, 2022, several environmental non-government organizations ("NGOs") officially challenged this decision and requested that the European Commission repeal the Delegated Regulation of March 9, 2022. The NGOs' legal action is based on the "request for internal review" procedure, provided under Article 12 of Regulation (EC) No 1367/2006 of the European Parliament and the Council of September 6, 2006 on the application of the provisions of the Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters to Community Institutions and Bodies (the "Aarhus Regulation"). Such procedure allows individuals and NGOs to request an administrative review of legal acts adopted by an EU institution or body on the grounds of a violation of European Union environmental regulations.

On substance, the NGOs argue that nuclear energy and natural gas should not be included in the taxonomy for sustainable finance, even with stringent requirements, and claim in particular that such inclusion is in violation of the Taxonomy Regulation itself as well as Regulation (EU) 2021/1119 of the European Parliament and of the Council of June 30, 2021, establishing the framework for achieving climate neutrality (usually referred to as the "European Climate Law").

Pursuant to the internal review procedure, the European Commission must answer the request within 17 weeks (which may be extended to 22 weeks). Depending on the Commission's answer, the NGOs may decide to take their claim before the Court of Justice of the European Union ("CJEU"). In any case, neither the internal review process nor the potential proceedings before the CJEU will suspend the implementation of Delegated Regulation (EU) of March 9, 2022. However, both nuclear and natural gas are considered as possible "transition" energy under the taxonomy which is meant to be revisited after a few years.

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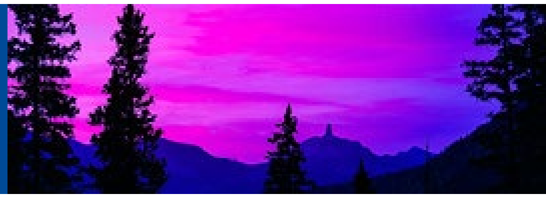

The Climate Report

**LITIGATION ISSUES & UPDATES**

## U.S. Supreme Court Signals Interest in Climate Change Litigation

Could climate change litigation be headed back to the U.S. Supreme Court? That prospect seems more likely after the Supreme Court issued an order on October 3, 2022, inviting the Solicitor General to file a brief expressing the views of the United States on whether to grant certiorari in *Suncor Energy (U.S.A.) Inc. v. Board of County Commissioners of Boulder County*.

In *Suncor*, a group of energy companies have asked the Supreme Court to review the Tenth Circuit's decision holding that federal courts lack jurisdiction over climate-related tort claims brought by the city and county of Boulder, Colorado. The Supreme Court's October 3 order suggests it has a significant interest in the *Suncor* petition: Where the Supreme Court calls for the views of the Solicitor General, empirical research shows that certiorari "is over 46 times more likely to be granted."

The *Suncor* case is one of roughly two dozen similar lawsuits playing out in courts across the nation. Since 2017, a number of state and local governments have sought to hold oil and gas companies liable for billions of dollars in infrastructure damages they have allegedly suffered or expect to suffer because of climate change. To date, these lawsuits have centered on purely jurisdictional disputes: Whereas plaintiffs have sought to litigate these actions in state forums, defendants have removed them to federal court, arguing that climate change is a global issue improper for state court adjudication.

The petitioners in *Suncor* argue that climate claims brought pursuant to state law are "necessarily and exclusively governed by federal common law" thereby rendering them removable to federal court. The petitioners have likewise argued that the Tenth Circuit's rejection of federal jurisdiction conflicts with other federal decisions, namely that of the Second Circuit, which found that New York City's similar state-law climate claims implicated federal common law. For their part, the city and county of Boulder argue that federal jurisdiction is lacking because their claims allegedly sound exclusively in state law.

If certiorari is granted, *Suncor* would mark the second time the Supreme Court has grappled with climate change litigation. In *BP p.l.c. v. Mayor and City Council of Baltimore*, the Supreme Court vacated the Fourth Circuit's remand of the City of Baltimore's climate change lawsuit to Maryland state court. The Supreme Court, however, limited itself to resolving a narrow question regarding the scope of appellate review applicable to the district court's remand order; it declined to opine on the broader jurisdictional questions underlying climate change litigation writ large. (A separate certiorari petition is currently pending in the Baltimore case seeking review of the Fourth Circuit's subsequent decision to affirm the remand order.) Now, the *Suncor* petition squarely presents the all-important jurisdictional questions for Supreme Court resolution.

Whatever its outcome, the *Suncor* petition has potential for an immense impact on the future of climate change litigation in the United States. There is no filing deadline for the Solicitor General's brief, but past practice suggests the brief could arrive as early as December, with the Supreme Court's certiorari decision coming before the end of the Term.

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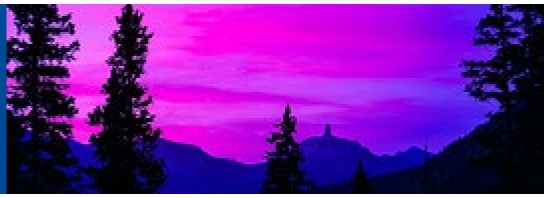

The Climate Report

**LITIGATION ISSUES & UPDATES**

## French Tribunal Dismisses NGO Suit on Carbon Neutrality Claims

In a judgement dated April 19, 2022, the Tribunal of Paris (the "Tribunal") dismissed a misleading commercial practice claim brought by a consumer protection non-government organization ("NGO") against an energy supplier (the "Company") regarding carbon neutrality allegations. The Company was advertising for an electricity supply offer, claiming that such offer was "carbon neutral and 10% cheaper."

The NGO argued that the Company's allegedly "carbon neutral" offer did not relate to the supply of electricity from renewable sources, but claimed it was carbon neutral without providing adequate information to support such a claim. The NGO requested from the Tribunal that the Company be ordered to remove all present and future advertisements which included claims that the electricity was "carbon neutral," that it was "produced from sources emitting almost no CO2 or other greenhouse gas" and that such electricity was "respectful of our planet and the future generations." The NGO alleged that such claims would lead consumers to believe that, if they subscribed to the offer, they would adopt a behavior contributing to the preservation of the environment and concretely fight against the greenhouse effect. In addition, the NGO requested information regarding the mix of energy sources as well the guarantees of origin (i.e., a certificate to demonstrate to a final customer that a given share or quantity of energy was produced from renewable sources, as defined by Directive 2018/2001 on the promotion of the use of energy from renewable sources) obtained by the Company be included in the advertisement for the electricity sold by the Company.

The Tribunal first noted that additional information had, in fact, been made available by the Company. In particular, some of the disputed claims were posted on the Company's website and accompanied by an asterisk, referring to the Terms and Conditions tab where the term "carbon neutral electricity" was defined. In addition, other disputed claims were posted on the Company's website with links to explanations available on the Company's FAQ page.

In the second step of its analysis, on the substance, the Tribunal found that the parties ultimately agreed on the definition of carbon neutrality in that it constitutes a mechanism for offsetting emissions and absorption. However, the Tribunal pointed out that the parties' underlying position and approach with respect to the issue were fundamentally different: the NGO considered that all greenhouse gas emissions should be reduced globally and that any other approach is either insufficient or biased, while the Company focused on its electricity supply activities with the idea that it is entitled to claim carbon neutrality based on the guarantees of origin it acquires. Finally, the Tribunal stated that that the notion of carbon neutrality is not yet the subject of a precise contextual definition, and each of the actors interpreted it according to their own point of view, depending on the interests for which they are responsible. As a consequence, the Tribunal dismissed the NGO's claim and ruled that the communications in question were not misleading.

Requirements surrounding the use of carbon neutrality claims have been clarified by the French legislator since this ruling. However, the takeaway from the April 19 ruling should be that, when no precise definition is available for a concept, the use thereof should not be considered misleading, as long as additional information and explanation are provided in support and easily accessible to the general public.

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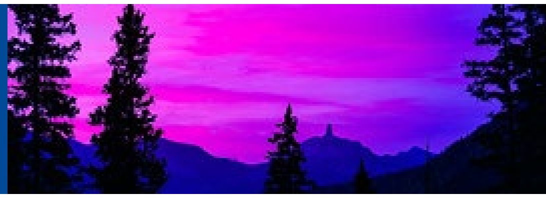



**TRANSACTIONAL ISSUES & UPDATES**

## U.S. Federal Reserve Announces Climate Scenario Analysis Program

On September 29, 2022, the Board of Governors of the Federal Reserve System ("Fed") announced that six of the largest U.S. banks will participate in a first-of-its-kind climate scenario analysis program. The Fed will provide participating banks with "climate scenario narratives" comprising climate, economic, and financial variables that the banks will use to analyze the impact of the scenarios on specific portfolios and business strategies (and potentially on their balance sheet and overall condition). Notably, the banks will not be able to choose their own scenarios. The Fed will use the banks' analyses to encourage them to build capacity to manage climate-related financial risks and will publish aggregate-level insights it learns from the program, but not bank-specific information. The Fed will provide additional details about the program in coming months, but it is expected to launch in early 2023 and conclude around year-end. This pilot program is significant because it may be the first step in using stress testing and bank regulatory capital to address climate risks. The Fed and other regulators may begin to impose requirements on banks in future iterations of climate-related stress testing, rather than mere "encouragement."

Following the 2008 financial crisis, stress testing emerged as one of the central tools employed by U.S. bank regulators to ensure safety and soundness of financial institutions. Annual stress testing exercises, in which the Fed and other bank regulators specify macroeconomic scenarios of varying degrees of severity, drive regulatory capital levels and shareholder dividends. Banks must demonstrate that they are able to maintain certain minimum capital levels even under externally defined stress scenarios. Failure to do so can result in banks having to increase capital, withhold dividends, or both. Banks have devoted considerable resources and developed complex frameworks over the last decade to comply with these stress test requirements, including models to predict the performance of business lines and balance sheets under a severe recession.

In addition to stress test outcomes, U.S. bank regulators also assess the overall quality of a bank's stress testing framework and process. Shortcomings in that framework lead to supervisory criticisms, which may be communicated to banks without ever being published or otherwise being made publicly available. Bank regulators also conduct a "horizontal" review of stress testing frameworks in which bank capabilities are compared to one another. These reviews have led to ever-increasing supervisory standards, driving continual refinement of all banks' stress testing frameworks and capabilities towards greater sophistication.

The Fed distinguishes this climate scenario analysis from stress testing since it asserts the former will not have capital consequences and because participation in the scenario analysis was not mandatory (at least, not formally). The Fed likewise asserts that there will be no supervisory implications either. That being said, the Fed notes in the same press release that it will "engage with those [participating] firms to build capacity to manage climate-related financial risks." Presumably, it will do so in the short run through the supervisory process by "encouraging" banks to increase their ability to measure and manage climate-related financial risks.

Historically, the Fed and U.S. bank regulators have introduced similar supervisory expectations at the largest and most sophisticated banks, only to expand their scope to include other large banks over time. Likewise, the Fed and U.S. bank regulators often foreshadow new legal requirements under the initial guise of pilot programs and guidance that initially do not impose new requirements. Accordingly, banks of all sizes should follow developments closely around this initial climate scenario analysis. Other U.S. bank regulators have signaled their intent to provide guidance to banks on managing climate risk in the future.

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The Climate Report

TRANSACTIONAL ISSUES & UPDATES

## Decarbonizing for Net Zero

Determining progress toward achieving carbon neutrality or "net zero" can be difficult. One complicating factor is existing and proposed carbon accounting metrics that use different "scopes" to count direct and indirect emissions. These overlapping scopes can result in double counting of emissions, a result that is inherent in any approach that includes indirect emissions. Another complicating factor is that there are questions about the validity and use of voluntary offsets to mitigate any remaining emissions after decarbonization efforts.

Over the past decade, decarbonization has principally focused on renewable energy, renewable and low-carbon fuels and compliance markets in specific locations such as California and/or particular economic sectors such as electricity generation. However, the number of opportunities that are going to present themselves over the coming years will only increase, and companies need to be prepared with a full set of tools to take advantage of them. For example, companies that want to achieve deeper decarbonization results while minimizing expenditures for carbon offsets could consider utilizing the following mechanisms:

- **Virtual Power Purchase Agreements**. A virtual power purchase agreement is an agreement that allows a user to purchase power from a renewable source when physical delivery is not possible (e.g., allowing a wind farm in Nebraska to "sell" its power to a factory in New York). The pricing mechanisms can be complex.
- **Electric Vehicle ("EV") Procurement**. In addition to the expanding market for passenger EVs, efforts to procure heavy duty EVs are emerging, especially for fleets that have regular routes with regular daily downtime. Companies engaging in these transactions have to think hard about specifications and warranties. A purchaser also should expect substantial negotiation around the allocation of incentives from the Inflation Reduction Act and other environmental attributes. These negotiations also can raise uniquely thorny issues around more traditional topics like intellectual property and data privacy.
- **Carbon Capture and Sequestration ("CCS")**. CCS has been used to capture carbon dioxide ("$CO_2$") created as a byproduct of ammonia production for decades, so the technology definitely exists. It just has not been applied to power plants and other carbon emission sources because of the cost. The Inflation Reduction Act offers a tax credit of $85/ton for new CCS projects over the next 10 years. There are a lot of fossil fuel power plants that are looking into carbon capture options at that price. One of the things that was an obstacle to using these tax credits in the past was the need to have tax equity finance structures in place to use the credits, and the Inflation Reduction Act took steps to make the credits more readily transferable.
- **Battery Storage**. A number of utility scale battery storage projects are on the drawing board. Because of recent issues with grid reliability in California and Texas, battery storage is increasingly being viewed as something that is necessary to accommodate the proliferation of renewable power sources while maintaining reliability. This is an important development because there is a misdirected tendency to think that gas-fired plants aid grid reliability. That is not necessarily the case in winter with limited gas supplies when home heating takes precedence.
- **Green and Blue Hydrogen**. There is a lot of work happening to commission the production of hydrogen from facilities that do not emit $CO_2$, either because they use CCS (blue hydrogen) or because the process is powered by renewable energy sources (green hydrogen). The interest in hydrogen stems from the potential for it to be distributed and dispensed much like hydrocarbon fuels. It also is relevant for applications and industries—such as steel—that need more energy than they are likely to be able to get

from electricity alone.

- **Compliance Markets***.* There are fundamental issues with carbon accounting that need to be addressed. These issues go to the double counting that is inherent in the different GHG emission scopes. While it would be great if a source could find a way to avoid counting someone else's emissions as part of its own GHG emissions, the system is set up to encourage companies to look at all of their inputs and outputs, not just their direct emissions. Compliance markets tend to work significantly better than voluntary markets in this space because of the necessary clarity of the standards, but compliance markets are fragmented and do not show signs of coalescing into something that is more uniform and universal.

Collaborating with experienced counsel can help companies utilize these mechanisms and other options in the most effective way possible.

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The Climate Report

**TRANSACTIONAL ISSUES & UPDATES**

## Recent Shifts in UK Government's Climate Change Policy

**Net Zero Review**

The Secretary of State for Business, Energy and Industrial Strategy ("BEIS") has commissioned an independent review of the UK government's approach to delivering its net zero target, in a way that is deemed to be pro-business and pro-growth. A consultation commenced on September 26, 2022, raising 30 questions on how the path to net zero can help meet the government's growth target of 2.5% per year. The consultation reveals something of a shift in the motivation for achieving net zero by 2050—from being primarily environmentally driven, to being seen as a possible economic opportunity.

The consultation is cast against the backdrop of events in Ukraine and the global economic crisis. It also happens to follow a landmark judgment of the High Court handed down in July 2022, which held that the government's existing net-zero strategy was unlawful because it failed to show how the UK's legally binding climate targets will be achieved. The government has now confirmed it will not be appealing that judgment. As such, the net-zero strategy must in any event be revised by no later than March 31 2023.

The consultation closed on October 27, 2022. The outcome of the consultation will result in a report including a set of recommendations that will be submitted to the Secretary of State for BEIS by the end of December 2022.

**Fracking**

Under Liz Truss' brief premiership, the UK government lifted its moratorium on fracking for shale gas in England. However, this moratorium has been reinstated by Rishi Sunak, the new prime minister. Bans continue to remain in place in Scotland and Wales. Fracking in the UK is a controversial topic due to concerns over the risk of methane leaks and seismic activity. The moratorium was introduced in November 2019 after an assessment by the UK Oil and Gas Authority concluded the risk of earthquakes could not be ruled out. No new evidence has come forward since this time on the risk having reduced.

**Oil & Gas Licensing**

When Truss was prime minister, the UK government confirmed its support for a new licensing round for North Sea oil and gas exploration. The intention is to secure the UK's energy independence by exploiting the full potential of the North Sea assets. Climate campaigners have claimed the new licensing round is potentially unlawful and they may mount a legal challenge.

**Onshore Wind**

Truss's administration also confirmed the UK government's intention to relax planning legislation for onshore wind projects, so that the consent process is in line with other infrastructure. This follows a 2015 de facto ban on onshore wind turbines in England. The support for onshore wind has been welcomed by the energy sector, and it is viewed as essential step if the UK is to reach net-zero emissions by 2050.

Whether Sunak will reverse the new oil and gas licensing round or the commitment to onshore wind projects remains to be seen. But there may yet be further shifts in the UK government's approach to achieving net zero by 2050.

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