

Commission delegated regulation – EU Sustainable Finance - EU classification system for green investments

Feedback from ClientEarth

ClientEarth is a non-profit European environmental law organisation with offices in Brussels, London, Madrid, Berlin, Warsaw and Luxembourg (as well as Beijing and Los Angeles). In total, ClientEarth currently has over 200 staff working on projects in more than 50 countries. Using the power of the law, we develop legal strategies and tools to address major environmental issues, we provide legal expertise and information to most of the environmental NGOs in Brussels (and beyond) and use the courts where necessary to enforce environmental law. The organisation is composed of programmes on Climate, Energy, Fossil Fuels Infrastructure, Trade, Oceans, Harmful chemicals, Plastics, Clean air, Wildlife, Forest, Agriculture and Environmental Democracy.

ClientEarth welcomes the Commission's initiative to start the development of Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (the "Taxonomy Regulation") by consulting the delegated regulation that will establish the technical screening criteria relating to climate change mitigation and climate change adaptation.

We also welcome the commendable effort made by the Technical Expert Group on Sustainable Finance (the "TEG") in preparing its Technical Report on the Taxonomy. Regrettably, the recommendations in the Technical Report of the TEG are not fully observed in the draft delegated regulation.

ClientEarth notes that in some recent initiatives of the EU, such as the Just Transition Fund, or the consultations on the Guidelines on State Aid for Environmental Protection and Energy and on Sustainability of competition law, the Taxonomy is mentioned as a possible tool to establish the sustainability of certain activities. While the use of the Taxonomy as a general benchmark for sustainability may be beneficial, it also entails risks that should be identified and duly mitigated. The primary purpose of the Taxonomy system is to establish a framework to facilitate sustainable investment, and hence it mainly targets financial markets participants. This system is still under development and will be made of different, complex rules. A thorough **gap analysis** must be conducted in each case to ensure that such references do not open loopholes that allow unsustainable economic activities to be deemed environmentally sustainable.

This issue is particularly visible in the case of adapted economic activities, which are considered as environmentally sustainable as a whole if they contain adaptation measures that protect the economic activity itself (Art. 11(1)(a), Taxonomy Regulation). We understand that the Commission intends to follow the TEG's recommendations and introduce different calculation methods, so that turnover is not considered for adapted activities and capex and opex are only considered when forming part of a plan to meet the technical screening criteria for adaptation (p. 30, TEG's final technical report on the Taxonomy, March 2020). However, this will be implemented through a separate delegated act. Since these different calculation methods are not in the Taxonomy Regulation, a simple reference to the Taxonomy Regulation would overlook them and potentially open a loophole for polluting but adapted projects to have their turnover or their whole capex and opex qualify as sustainable.

Electricity generation from gaseous fuels

ClientEarth welcomes the 100gCO₂e/KWh life-cycle GHG emissions threshold in the technical screening criteria for substantial contribution to climate change **mitigation** and do no significant harm ("DNSH") to the rest of objectives by the economic activity "Electricity generation from gaseous and liquid fuels" (section 4.7 of Annex I). We encourage the Commission to maintain it in the final delegated act, since it is basic for a science-based and credible application of the Taxonomy Regulation. To ensure that the effects of the threshold stay relevant through time, we also request the Commission to follow the TEG recommendations and specify that the 100g CO₂e/kWh lifecycle emissions threshold shall decrease every 5 years in line with a net-zero 2050 trajectory.

However, we consider that this draft delegated regulation misses the opportunity to directly exclude economic activities relating to fossil gas from the technical screening criteria, in the way that power generation from solid fossil fuels was excluded by the Taxonomy Regulation (Art. 19(3)). Fossil gas should not have been considered at all in the technical screening criteria. This could have helped avoid future risks of fossil gas lock-in and also acknowledge the difficulty of deeming any activity involving the burning of fossil fuels as sustainable by any reasonable standard.

Regarding the technical screening criteria for substantial contribution to climate change **adaptation** and DNSH to the rest of the objectives for the economic activity "Electricity generation from gaseous and liquid fuels" (section 4.7 of Annex II), we note that the language in the draft delegated regulation published for public consultation differs from the previously leaked draft, as well as from the TEG's recommendations. We recommend that the DNSH to mitigation criterion at least reverts to 262gCO₂e/KWh lifecycle emissions, as recommended by the TEG, and that it is verified by an

independent third party, instead of the unverified 270gCO₂e/KWh direct emissions in the draft published now for public consultation.

We also suggest the improvement of the parameters for substantial contribution and DNSH in sections 4.7 of both Annexes for better alignment with the objectives and provisions of the Taxonomy Regulation. We note, for example:

- That the DNSH to the transition to a circular economy criterion is left blank in both cases, while conditions on the decommissioning of plants should have been included.
- That control and verification mechanisms should have been introduced to ensure effective compliance with the technical screening criteria.

Methane

ClientEarth is concerned to ensure that all energy derived from non-renewable sources is excluded from the draft delegated regulation. If any non-renewable energies are included, as pointed out in the TEG report, a standard such as Product Environmental Footprint should be applied to ensure measurement of all lifecycle emissions. This includes actual physical measurement of methane leaks and vented and flared emissions, from the point of extraction to end-use. Emissions thresholds should be set in alignment with the EU's 2030 and 2050 climate targets. We urge adoption of the TEG recommendation that the emissions threshold decline every five years so that it reaches zero at the time required to align with the EU's 2030 and 2050 climate target.

Corporate Lobbying and Advocacy

We recognise that corporate involvement in policy can be a legitimate activity and corporate feedback can play an important role. However, we are concerned that lobbying in relation to the EU Sustainable Finance programme, and this Delegated Act specifically, mistreats the Taxonomy as an issue of regulatory burden, not as a science-based classification for use by finance actors aiming to achieve transition in the real economy.

In particular, we are concerned that intensive lobbying by the fossil fuel gas industry risks that the Taxonomy fails in its aim of being a credible, science-based market standard to accurately manage environmental risks and opportunities. If long-lived gas power or heat infrastructure investments are squeezed in through an exception to the emissions threshold or other loophole, there is a risk that the EU standard will become meaningless as a reference point for investors and, critically, will not serve to re-orient capital flows toward genuinely sustainable investment.

International legal standards and expectations regarding corporate lobbying provide a consistent message: corporate advocacy and lobbying must not water down urgently needed effective climate public policy:

- The OECD Guidelines for Responsible Business Conduct require that business enterprises operating in OECD member states should “[c]ontribute to the development of environmentally meaningful and economically efficient public policy”.
- The [OECD Recommendation on Principles for Transparency and Integrity](#) sets public body governance standards to enhance transparency and safeguard integrity.
- The [Safe Climate Report](#) of the UN Special Rapporteur on human rights and environment states that “businesses should support, rather than oppose, public policies intended to effectively address climate change.”

- The UN Guiding Principles on Business and Human Rights specify the content of the corporate responsibility to respect human rights throughout their operations. The commentary to the principles emphasizes the need to integrate the corporate responsibility to respect human rights with regard to “lobbying activities where human rights are at stake”, as with the Taxonomy.

The investment community will be a key user of the Taxonomy information, and large institutional investors have already made their position on corporate lobbying of this kind clear in some detail. In October 2018, the Institutional Investors Group on Climate Change (more than 270 members, mainly pension funds and asset managers, across 16 countries, with over €35 trillion in assets under management) and a number of long-term large institutional investors supported the European Investor Expectations on Corporate Lobbying on Climate Change.

The investor expectations call for corporate lobbying to be aligned with Articles 2.1(a) and 4.1 of the Paris Agreement. Companies should ensure any engagement conducted on their behalf or with their support is aligned with a safe climate, in turn protecting long-term portfolio value. Specifically, corporates engaging in lobbying, such as the gas industry engaging on the Taxonomy Delegated Act, are expected to:

- support and lobby for effective measures that aim to mitigate climate change risks and limit temperature rise to well below 2 degrees Celsius; and
- act in situations where policy engagement is not aligned with company policy, or with the goals of the Paris Agreement, including where engagement is undertaken on the company’s behalf or with its financial support by third party organisations.

Investors will be actively engaging with corporates through climate stewardship programmes in the coming AGM season, but in the meantime the gas industry should not be able to rig the Taxonomy to protect their existing business models. By doing so, they seek in effect to avoid market and investor scrutiny of the flawed business and sustainability case for increased investment in fossil fuel gas.

Chemicals and chemicals heavy activities (manufacture of chlorine and manufacture of organic basic chemicals)

Despite the recognition in the Taxonomy Regulation of the importance of targeting hazardous chemicals and their combined effect in Recital 6, Articles 12(1)(c), 13(1)(d), 14(1)(c) and 15(1), as well as the commitment of the EU institutions to the detoxification of the economy in the chemical strategy and the circular economy action plan, the approach to chemicals activity demonstrated in the TSC is very weak. This is both in terms of the chemical substances included under “Manufacture of organic basic chemicals”, as well as the DNSH criteria, which fall far short of ensuring that the environmental benefit of the economic activity outweighs the environmental harm

The taxonomy regulation is clear – for economic activities that have a significant impact on the environment, safeguards are set to avoid granting an unfair green distinction. Recital 39 says in particular that for such activities must be avoided “environmentally harmful lock-in effects (...), during the economic lifetime of the funded economic activity. Those criteria should also consider the long-term impact of a specific economic activity.” Recital 40 adds that “An economic activity should not qualify as environmentally sustainable if it causes more harm to the environment than the benefits it brings” and that the minimum requirements necessary to avoid significant harm to other objectives can go beyond minimum requirements laid down in EU law.

However, chemicals activities that have a significant impact on health and the environment and for which the benefits in terms of climate change objectives **do not outweigh** the harms to other environmental objectives have been included in the draft. These include:

- Aromatics production;
- Vinyl Chloride monomer (VCM) production;
- Styrene production;
- The production of Chlorine for other end-use that are not essential for health, safety or the functioning of society (in application of the definition developed in the context of the Montreal Protocol and being developed under REACH and more horizontally by the Commission).

In the same logic, plastic and building components and materials must not contain the substances listed in the point above in order to be included in the Taxonomy.

- More generally, the production of any substance meeting the criteria of Substances of Very High Concern (SVHC) under the EU Chemicals Regulation REACH (REACH “candidate list”), as well as those listed in the Stockholm Convention on Persistent Organic Pollutants, the Rotterdam Convention on the prior informed consent procedure for certain hazardous chemicals and pesticides in international trade, the Minamata Convention on Mercury, the Montreal Protocol on Substances that Deplete the Ozone Layer, and of active ingredients that are listed as classification Ia (“extremely hazardous”) or Ib (“highly hazardous”) in the WHO Recommended Classification of Pesticides by Hazard.

Article 17 leaves no doubt on the fact that for manufacturing activities, not only the production counts but the use phase of the product as well “both the environmental impact of the activity itself and the environmental impact of the products and services provided by that activity throughout their life cycle shall be taken into account, in particular by considering the production, use and end of life of those products and services.”

However, the conditions set by the Commission for the chemical or chemical-heavy activities to not “do significant harm” focus solely on the production process, without any considering for the impact caused throughout the life-cycle of the products they lead to. They also do not consider the lock-in effect that a financial support might create towards those activities when safer alternatives are struggling to gain market shares.

It is true that this assessment may be complex, but again the Regulation offers an answer in its Recital 40 “Where scientific evaluation does not allow for a risk to be determined with sufficient certainty, the precautionary principle should apply in accordance with Article 191 TFEU.”

Contrary to this requirement, the absence of information on the product stage and its impact has not lead to more protection, but to less. The Commission even weakened the conditions set for the DNSH in comparison to those proposed by the TEG, including on very sensitive objectives for chemical such as water protection (withdrawal of the requirements to comply with EU law, which should be re-instated as an obligation to prove compliance with applicable water law), or circular economy (withdrawal of the waste objectives, that must be reinstated). This is particularly worrying considering that the proposals of the TEG already needed to be reinforced (for example with an obligation to monitor all emissions into air, soil and water and to disclose the results).

In conclusion, the Commission must withdraw the activities listed above from the taxonomy in order to remain within the limits of its power.

In any case and a minima, the Commission must considerably strengthen the DNSH conditions that the economic activities will have to respect to be considered as sustainable, and take into impact the potential impact of the products on top of the production process.

Manufacturing of plastics in primary form

The same concerns we set out above in relation to chemicals manufacturing regarding a) the wide scope of the description of the manufacturing activity, b) a failure to consider the ‘use’ phase of the product, and to take a ‘lifecycle approach’, as mandated by Article 17; and c) failure of the DNSH criteria to adequately address environmental harms caused by the manufacturing process apply also to the manufacturing of plastics in primary form.

First, we seek clarification in the TSC that the definition of manufacturing plastic in primary form does not include pre-processing steps such as the development of feedstock or monomers through chemical recycling, which are more properly classified as waste management, not manufacturing. Moreover, chemical recycling for plastics manufacturing should only be supported a) for degraded and contaminated plastic, not plastics originating from separate collection and b) if a substantial environmental performance improvement over the full lifecycle can be demonstrated in comparison to plastic manufactured from virgin fossil fuel feedstock and mechanical recycling.

Again, in relation to plastics manufacturing, no consideration is given to the environmental impacts of the product produced. Indeed, the TEG’s proposal regarding a recycling/not for single-use purposes threshold has not been included and not been replaced. The draft delegated act now contains no criteria addressing the prevention of plastic waste. At the very least, we call for the reinstatement of the TEG’s proposed criteria.

Finally, the draft does not provide sufficient clarity on the standards to be used to assess GHG lifecycle emissions. The Product Environmental Footprint (Commission Recommendation 2013/179/EU) methodology should be favoured and the reference to ISO 14064-1 deleted, as it refers to organisations rather than to products and is therefore not easily applicable.

