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COP27 – WHAT CAN WE EXPECT?

– THOUGHT LEADERSHIP

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COP27 – the UN Climate Change Conference of the Parties – is intended to build on the work that took place at COP26 last year and move on from pledges to implementation. This year's Conference is lower key and more procedural. Against a backdrop of the Russian invasion of Ukraine, increasing geopolitical tensions, food, and energy security issues, rising inflation and an uncertain economic outlook, Clifford Chance experts take a look at the themes of this year's conference and what is likely to be achieved.

The main outcome of COP26 was the Glasgow Climate Pact. This emphasises the need for parties to strengthen their climate emission reduction targets (Nationally Determined Contributions – NDCs). The EU has adopted a 'net zero by 2050' emissions target. The UK has pledged a 78% cut in carbon emissions by 2035 and China says it will reach net-zero in 2060 and peak its emissions well before 2030. Meanwhile, India has pledged net zero emissions by 2070 and the new Australian government has pledged to cut carbon emissions by 43% by 2030 – up from the previous government's target of between 26 and 28%. However, so far, few countries have submitted revised NDCs – and those that have are smaller, developing countries which have fewer emissions to cut.

Against that background, the latest scientific prediction is that we're on course for a 10% increase and not a 45% decrease in emissions by 2030, which implies approximately 2.5 to 2.6 degree warming by the turn of the century. "Perhaps recognising that gap between talking the talk and walking the talk, the Presidential vision statement for COP27 is very clear that it's about moving from negotiations and planning to implementation, urging action on prior agreements," says Roger Leese, who co-heads Clifford Chance's global business and human rights practice.

The first objective of COP27 is mitigation – efforts to reduce or prevent the emission of greenhouse gases either through the use of new technologies and renewable energy sources or by making older equipment more energy efficient or by changing management practices or consumer behaviour.

The second objective is around adaptation – how each individual country is going to adapt to climate change and to help other, more vulnerable nations do the same, so that they can protect their citizens. Last year, developed countries agreed to at least double the finance available for adaptation and many stakeholders are calling for even greater levels of adaptation funding.

"The third area of focus in the negotiation – and often described as the thing that never leaves the negotiation room – is climate finance. Developing countries, are making loud calls for developed countries to provide sufficient and adequate financial support, particularly to the most vulnerable," says Leese.

In 2009, rich countries committed to providing US$100 billion a year, to support poorer countries, but it hasn't happened yet. There seems to be some optimism that COP27 may make it a reality in 2023. US Special Climate Envoy John Kerry has indicated in recent speeches that progress is being made and the United Nations will launch a report at COP27 to inform the negotiations on finance-related agenda items.

Kerry also indicated at an event at the Council for Foreign Relations that the US is also prepared to discuss the issue of compensating poorer countries for loss and damage due to rising greenhouse gas emissions, mostly from rich industrial nations. To provide a sense of scale, Pakistan estimates that it suffered about US$40 billion worth of damage in the recent floods.

The negotiations will also include technical discussions to specify the ways in which nations should practically measure their emissions to create a global level playing field for all countries. There are also a number of high-level round tables taking place. These will focus on: just transition; food security; innovative finance for climate and development; green hydrogen, water security and climate change; and sustainability of vulnerable communities.

The role of Africa

COP27 has been described as the 'African COP' not only because of its location, in Sharm El Sheik, Egypt, but because Africa – and how it will deal with the severe effects of climate change – is likely to be a major focus of discussions.

"Some of the worst effects of climate change will be felt in Africa, and relative to the rest of the world, Africa's contribution to greenhouse gases has been negligible," says Clifford Chance Partner, Olamide Oladosu, who specialises in energy and infrastructure projects across Africa. "Some countries are signing up to pledges and targets that are unlikely to be met, to satisfy domestic political audiences, but it actually does more harm than good". He adds that African countries are likely to focus on a number of issues including the fact that global positions and policies need to be more inclusive and reflective of the realities on the ground. "For example, suggestions that Nigeria decarbonises and switches to renewables is an existential issue – it's asking a country to replace 60 to 70% of its foreign earnings. At the same time, many people in Africa feel that their need for access to energy has dropped down the list of priorities. If a country is sitting on deposits of gas, but people can't access it, they are turning to firewood instead," he says. He also adds that discussions about compensation for loss and damage are not sufficient. "There is a feeling that it hasn't made it onto the agenda simply because Africa does not have the loudest and most influential voices in the room. But climate change is a global problem and its going to take a global solution."

What's the US position?

The US introduced the Inflation Reduction Act (IRA) in August, which represents the culmination of efforts by President Biden and Democratic Party lawmakers to enact comprehensive climate change legislation. It is a product of a great deal of compromise and hard-fought negotiations between the progressive and moderate wings of the Democratic party, but it includes funding for climate change mitigation, primarily by providing for a host of tax credits for solar, onshore and offshore wind, standalone energy storage, carbon capture and green hydrogen projects, as well as funding for sustainable transportation fuels and electric vehicle manufacturing. Many analysts predict that tax credits under the IRA, together with loan guarantees and direct grant programs under the auspices of the US Department of Energy, will spur further investment in the renewables sector and drive the building of critical infrastructure – such as electric vehicle charging and energy storage – that is necessary for energy transition. For more details on the Act see our **briefing**

"The Act was the last chance for Biden and the Democrats to pass any form of comprehensive climate change legislation and it really can't be overstated how much of a win this is not just for Biden, but also for the US," says Greg Jehle, a Senior Associate in the Clifford Chance Energy and Infrastructure Group.

Although Republicans have shown little interest in the past in enacting any substantial climate change initiatives and not a single Republican in the House or the Senate voted for the Act, the Inflation Reduction Act is unlikely to be repealed in the near future, even if the Republicans retake the Presidency in 2024, for several reasons. As Jehle explains: "The tax credit provisions of the law are supported by key business constituencies that otherwise often support the Republican party. And the economic benefits of the law will soon start to be felt in Republican leaning states as well as Democratic states."

He adds that the IRA provides the US with credibility at COP27 by demonstrating its commitment to deliver on stronger climate policies and by providing a clearer path towards meeting, or perhaps even surpassing, its reduction in emissions by 50-52% from 2005 levels by 2030. The U.S. Special Presidential Envoy for Climate, John Kerry, is expected to encourage other participants at COP27 to set more aggressive targets.

"However, broadly speaking, the incentives in the IRA focus on mitigation and on incentivising climate infrastructure investment in the US itself. The Act does not provide for climate finance for developing nations or for substantial measures on adaptation. So, representatives of developing nations, and the Global South will likely press the US on climate finance."

The issue of loss and damages will likely remain very contentious, although John Kerry has expressed some openness towards discussing the issue. Developing nations are pressing for a dedicated fund to be established to deal with loss and damage, while the US has previously leaned towards using existing, international funding streams that have previously been established to deal with different climate related issues.

Much of the US's ability to deliver on its commitments will be impacted by domestic politics and international geopolitical rivalries. President Biden pledged to provide US$11.4 billion for climate finance at COP26, but that may be difficult to achieve in practice. In addition, in August, China suspended direct climate negotiations with the US, following the visit to Taiwan by the Speaker of the US House of Representatives, Nancy Pelosi.

"Concerns regarding energy security may also lead to some uncertainty as to the durability of the US's commitment to addressing climate change head on. The fall out of Russia's invasion of Ukraine has highlighted the challenges of balancing climate action with energy security and affordability. The US is no exception. While the US does not use much Russian gas, some in the US government and the oil and gas industry see the US stepping in to fill the gap in world energy demand, which will have a negative impact on the US's ability to meet its emissions reductions targets under the Paris Agreement.

The impact of Article 6

Article 6 was the forgotten article of the Paris Agreement, but two main decisions were issued in Glasgow at COP26.

One was around article 6(2). This is the article that allows countries to transfer internationally transferable mitigation outcomes to each other. They then have to adjust their nationally determined contributions (NDCs). These are called cooperative approaches. At COP 26 we got the criteria for those mitigation outcomes - they must be emission reductions or removals – but there was no mention of avoidance. This decision also set out the detail of how to make corresponding adjustments, which is an accounting tool to ensure no double counting of emission reductions.

The second decision relates to the article 6(4) mechanism, which is the foundation of the UN-led carbon market for the trading of emissions reductions. "The decision really set out the rule book for how you register a project, the approvals you will need from a host country and how it will be assessed independently. The project is registered, and the emission reductions need to be monitored then verified before being issued," explains Nigel Howorth, Head of the Global Environment Group, who specialises in environment, climate change, and energy law.

Of critical importance is that once they are issued, 5% of the credits are taken for an adaptation fund and another 2% are cancelled immediately as part of delivering an overall mitigation of global emissions.

The decisions also set out that the corresponding adjustment must be made on the first transfer of these credits. So, at COP26 in Glasgow, the mechanism was established. But it still needs lots of detail to operationalise the mechanism, which is evident in the agenda and work plan of the UN Supervisory Body, which oversees it all.

"There is also the issue of how each country is going to implement this Paris mechanism. And how quickly would they be able to do it? And there's always the risk of them getting it wrong, particularly if, as some are already trying to do, they implement it before we even know all of the detail," he says.

Another big issue, which wasn't resolved, relates to the position being taken by the African nations on what have become known as sovereign carbon credits and the carbon emission avoidance projects falling under REDD+. As noted above, the criteria for the reduction of forest emissions and enhancing forests didn't include avoidance of emissions - what a number of nations are trying to do is bring these into the Paris trading mechanism.

"The reasoning is that these projects are going to make a huge contribution to achieving the Paris goals, the amount of credits we're talking about, you can't do it without them. Carbon sinks are absolutely critical. And there should be discussion about the rewards for their preservation," Howorth adds.

There are two issues about bringing REDD+ projects into the article 6 mechanism. Firstly, they are not really suited to a trading market. The trading market is about making reductions in one place and selling them to another place so that they can offset where they can't reduce their emissions. Also, if you bring this amount of sovereign carbon credits suddenly into the system that could have very significant consequences on the price. The price for credits is making projects viable now. Another unresolved issue, which is being discussed, is the existing clean development mechanism (CDM). How do you bring existing ongoing projects into a new mechanism?

So, what can we expect at COP27? The UN Supervisory Body for the Article 6 (4) mechanism will meet for three days, and they are tasked with putting recommendations to the main COP. They are focusing on two things:

- The additional responsibilities of the Supervisory Body and the countries that are going to host Article 6 projects. They will elaborate on some of the national arrangements that would need to be put in place in order to go through the Article 6 full mechanism. So, we're going to see more rules, more bureaucracy. But it's there to operationalise the mechanism.
- The issue around emissions avoidance, and we understand it is something that is going to be pushed by certain nations, but it is expected that there will be very strong resistance from a number of Western nations who want to preserve the trading model as they believe that it is one of the key solutions to the capital flows that are needed.

The Supervisory Body has also been asked to produce detail on the transition from the CDM into the new Article 6 mechanism. The concern now, is it just makes it look even more like the CDM which had its drawbacks. It was big. It was complicated. It was expensive. Which may put a number of projects off from coming through the new Paris mechanism. There will be some useful detail on the registration and authorization process, and some standardisation of how that would work and how the registries would connect.

There are a few other issues which relate to the Paris Agreement and the voluntary carbon markets, which may not get tackled at COP, but which may be raised in the negotiations or on the fringes of COP.

One is the issue of double counting and corresponding adjustments. The Paris mechanism is quite clear on that – if one country claims a reduction in their NDC, another cannot. And so, you have to have a corresponding adjustment. The unresolved issue is where host countries have a broad NDC which captures a lot of projects that are in the voluntary carbon market and are not going to go through the Paris mechanism.

A number of governments including Indonesia, Honduras, India, have brought in moratoriums, or regulations banning or restricting the exports of carbon credits because they're very concerned about their ability to meet their NDCs. However, they shouldn't be concerned because the legal position is quite clear. If these projects are not authorised for Paris purposes to be counted against the NDC, then they're in the voluntary carbon market and no corresponding adjustment is needed.

But there's uncertainty and there's hesitation on certain projects by developers, buyers are unsure, but most importantly, for those capital flows, investors and funders are nervous.

At COP 27 the Supervisory Body may issue some guidance around corresponding adjustments, but we also expect that the voluntary carbon market governing bodies, i.e., the VCMI in collaboration with the Integrity Council may bring out some guidance on this.

The other thing, which COP 27 won't deal with, but there may be further announcements on is the issue of double claiming. That's when a country claims an emissions reduction which they count against their NDC, and at the same time, you've got a private entity buying those credits in another jurisdiction and saying they're going to use those credits to offset their emissions.

"There are two people claiming the same reductions, but it's not strictly double counting, it's double claiming. There are very strong views either way on this, some say it's absolutely fine and justify it. Others say, no, this is all greenwashing. The problem we've got is that the carbon standards that operate in the voluntary carbon market, and the governing bodies have slightly different positions on this. It may just be semantics, but there needs to be some statement about that," says Howorth.

Something else we may see again is the governing bodies, and also other players in the voluntary carbon market looking at a communication strategy. There's been a lot of adverse publicity recently, a lot of greenwashing claims against offsetting and, this has detracted from a number of the key benefits of the carbon market, and its ability to direct, very significant funding into climate action.

"So, I think we may see a communication strategy coming out, which is looking to sell the virtues of the market. It will be acknowledged that it's not perfect, but that should not get in the way of the good."

What impact will private sector finance have?

The traditional focus of COP meetings is on government commitments, but COP26 in Glasgow spearheaded the prominence of the private sector in COP discussions.

One of the highest-profile announcements in Glasgow was from the Glasgow Financial Alliance for Net Zero (GFANZ). This is a coalition of financial institutions co-chaired by Mark Carney and Michael Bloomberg, whose members commit to mainstreaming the decarbonisation of the economy and reaching Net Zero by 2050. GFANZ originally emphasised that its membership and goals were grounded in the UN's Race to Zero campaign for credibility and consistency.

The big announcement in Glasgow was that GFANZ membership had grown to 450 firms, from 45 countries, managing US$130 trillion of private capital. On that basis, there were predictions that the private sector would fund around 70% of the investments needed to deliver Net Zero. It was seen as game changing that such a broad group of the financial sector bought in to delivering the commitments of the Paris Agreement.

So, what can we expect from COP27? Overall, fewer bold new announcements are expected, but we see a couple of themes dominating.

"The first is the idea of turning existing commitments into practical action, and the second is transition; both transition plans and those becoming more granular, and the need for transition finance" says Clare Burgess, a Clifford Chance Partner specialising in clean energy, infrastructure and sustainable finance.

GFANZ said in its recent progress report that whilst 2021 and 2022 focused on the commitments, frameworks and guidance, 2023 will be the year of action.

One of the pre-COP reports from the UNFCCC's Standing Committee on Finance looks at ways to make private sector finance flows more sustainable. It notes a 16% increase in policy and regulatory measures since 2020 in the area of green finance and highlights the Race to Zero and GFANZ initiatives as driving the participation from private financial institutions into both developing and developed markets.

"But at the moment, GFANZ members are treading quite a difficult line. They have many stakeholders, not least their clients, but also their employees and their regulators. On the one hand financial institutions are signing up to voluntary commitments alongside complying with increased regulatory requirements, particularly in Europe. Despite this voluntary action, some groups accuse them of not doing enough and of greenwashing by making public commitments without sufficient action," Burgess says.

And she adds: "But claims are flying in from other directions that they are going too far. For example, in October in the US, Republican Attorney Generals from 14 States announced an investigation into the climate mitigation strategies of six of the large banks saying they could be illegally blocking fossil fuel companies from accessing financial services and undermining other greenhouse gas intensive industries, such as agriculture. They sent civil investigative demands asking banks that signed up to GFANZ to explain how they have incorporated those commitments into their business operations."

It is clear that banks have not stopped lending to the fossil fuel industry. Nor is divestment a policy of GFANZ – on the contrary, engagement rather than divestment is encouraged.

Notwithstanding the challenges from the Red states, the UN's Race to Zero is calling for increased ambition and action from its members, including in June this year, a requirement to "phase down and out all unabated fossil fuels as part of a just transition," requiring detailed transition plans and leaving trade associations that "persist in not aligning with scientific pathways."

There have been some unconfirmed reports that institutions are struggling with these increased requirements, and we know at least two members have left GFANZ citing reporting demands. GFANZ recently dropped the requirement for members to partner with Race to Zero, but left this as the encouraged path.

Still, GFANZ have continued with practical steps to help its members with their sustainability goals, and recently published a pan-sector framework for Financial Institution Net-Zero Transition Planning, with guidance on enabling transition finance through finding and funding climate solutions (new technologies and products), funding business models which are already net-zero-aligned, or those companies on a credible pathway there, and managing the phase out of high-emitting assets.

GFANZ have also issued a one-year update on its call to action to G20 countries, outlining the policy levers G20 governments need to deliver on their climate commitments, including economy-wide transition plans, underpinned by sectoral pathways and policies.

It is clear that financial institutions and the private sector alone can't deliver the action required without the pipeline of investable projects and the related shift in the real economy, so much of GFANZ's work will be on the policy side to encourage governments to make policy decisions and potentially new regulations, which provide the right environment for investments at pace and scale.

"All of this brings out the point on transition finance – it is clear that we cannot just focus on the cleanest and greenest activities, but rather we need to look across economic activity and ensure we are engaging with high emitters and their transition plans. The private sector – both in terms of the companies themselves and financial institutions which help enable their investments – remain central to this action," says Burgess.

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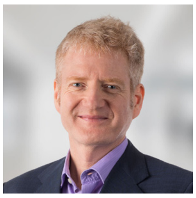

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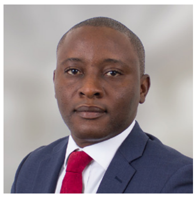

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