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COP28: WHAT IT MEANS FOR BUSINESSES

– THOUGHT LEADERSHIP

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In this extract from our recent Perspectives webinar, we explore some of the major themes that came out of COP28, including renewable energy, financing and what it means for businesses.

"COP28, which took place in Dubai in December 2023, saw the first Global Stocktake and it is clear that the world is not on track to achieve the emissions reductions required to keep temperature rises within the limits agreed in Paris at COP21. As well as the formal decisions of COP28 – referred to as the UAE Consensus (and discussed below) – there was a host of announcements of initiatives and commitments by various state groupings as well as by business and third sector organisations," says Roger Leese, a London-based Partner and Chair of Clifford Chance's Net Zero Delivery Group, who attended the event.

"198 countries needed to reach consensus and there were clearly some states that were putting their money where their mouth is – the UAE for example, which launched the new US$30 billion climate finance fund, ALTÉRRA, which aims to improve the flow of money to reduce emissions in the Global South," says Jeroen Ouwehand, a Clifford Chance Partner based in London who also leads the firm's Global ESG Board. "If you look at what was agreed at COP28, you will find a wide array of agreements, pledges and commitments, some more binding than others, which can be quite difficult to navigate. The UAE Consensus is not binding on companies, but it may have an effect in terms of investment opportunities and also potentially of climate-related litigation," he says.

What came out of COP28 on energy transition?

Agreement at COP28 focused heavily on energy transition and fossil fuels were named in the COP text for the first time. "Perhaps the key outcome for business from COP28 is certainty that the shift from fossil fuels has begun and will accelerate," says London-based Clifford Chance Partner, Clare Burgess. The UN Climate Change Executive Secretary Simon Stiell said in his closing speech that whilst we didn't turn the page on the fossil fuel era in Dubai, this outcome is the beginning of the end and now all governments and businesses need to turn these pledges into real economy outcomes without delay. "I think the rationale for companies to invest in renewable and clean energy options becomes ever clearer – you avoid stranded asset risk, early adoption generally saves money in the long term and it's a huge opportunity to invest and lead in a clean, low-carbon future," Burgess says.

The challenges of tripling renewable energy by 2030

COP28 called for the tripling of renewable energy by 2030. At the end of 2022 there were around 3,400GW, or 3.4TW, of installed renewable capacity globally and COP is looking to increase that to more than 11TW. "It will be challenging. There is the need for grid improvements, planning reforms, the need to manage intermittency with storage solutions or demand-side management, the need to support and grow the supply chain, and the need to revisit tariffs and auction support in light of inflationary pressure on costs," says Burgess. "Can we do it? Yes, we can, with quite a lot of help from the humble solar panel and, in no small part due to the role China is playing, installations of renewable power have been surging. We just need to sustain that trend," she says.

In 2023, we expect to have added 440GW of renewable power capacity globally, which is 107GW more than prior years, the largest increase ever and equivalent to more than the entire installed power capacity of Germany and Spain combined. Solar PV accounts for about two thirds of this, both large utility-scale and small distributed systems. They are increasing in all major markets, including China, the European Union, the United States and India.

This is largely driven by cost competitiveness against fossil fuels, and energy security concerns. Overall, cumulative world renewable capacity is forecast to reach over 4,500GW at the end of 2024, equal to the total power capacity of China and the US combined. "Governments will surely come back from COP28 with plans to reinvigorate auctions and tariff programmes to accelerate renewable development, but governments cannot fund everything," Burgess says.

The International Energy Agency predicts that market-driven procurement of renewables is expected to account for 36% of utility solar PV and wind capacity expansion next year (excluding China). Market-driven means the buyers of power – often corporates – procure power directly from the developers by entering into corporate Power Purchase Agreements (PPAs). The US leads expansion in corporate PPAs, followed by Brazil, Australia, Spain and Sweden, all motivated by the economic attractiveness of these technologies, the opportunity to hedge against rising and volatile power prices, and sustainability goals.

"We are certainly seeing this as a growing area, and a way for the private sector to accelerate faster than government programmes may take us. In Europe we have seen growth in companies entering PPAs, starting with Amazon, Google and Microsoft, but now encompassing a far wider range of corporates. Here is a way in which corporates can really drive development of renewable power for sustainability goals, and improve supply and price certainty," Burgess says.

Developing countries and access to finance

A key challenge is ensuring that the least developed countries, including many that have set a 100% renewable energy target, have access to the finance required to enable them to achieve their ambitions. Development finance institutions such as the World Bank have a role to play by supporting blended finance to cover key risks or take first loss positions, to catalyse private sector investments. "There are some great examples of structures being deployed, but we need a lot more of them," says Burgess. You can read more about blended finance in our briefing **Funding the energy transition: Mobilizing private finance for net zero**.

A number of initiatives were announced at COP28, often combining the private sector and the philanthropic sector to mobilise finance. These include the Energy Transition Accelerator, launched by the US Department of State, the Bezos Earth Fund, and The Rockefeller Foundation, which is pioneering a sectoral-scale carbon crediting approach that will incentivise participating countries to use clean power, retire fossil fuel assets and enhance storage capacity, transmission and distribution. It is expected to mobilise up to US$207 billion in transition finance by 2035 and banks such as Bank of America, Morgan Stanley and Standard Chartered have pledged support.

Meanwhile, the UAE launched ALTÉRRA, a US$30 billion catalytic private finance vehicle, which seeks to mobilise a total of $250 billion for global climate action with BlackRock, Brookfield and TPG. ALTÉRRA is looking to have a multiplier effect and reduce barriers to investment in under-invested markets, including the least developed countries and Small Island Developing States. Its focus areas are the energy transition, industrial decarbonisation, sustainable living and climate technologies.

Clare Burgess says: "Many of our clients are financial investors, and investors of private capital, and what we are hearing from them is that, outside their focused energy transition funds, they are seeing climate change and the energy transition as an investment theme which can be used as a lens and applied to all investments. Are there more opportunities for operational value creation where a focus is placed on energy efficiency and sustainability? With the right people and knowledge in the team, this can really be a differentiating factor for an investment strategy."

Carbon trading and credits

Under the Paris Agreement, Article 6.2 is a mechanism to enable countries (or created the basis for countries) to trade or exchange domestically generated emissions reductions and removals in the form of Internationally Transferred Mitigation Outcomes (ITMOs, which are akin to carbon credits) through bilateral or multilateral agreements, and for the purchasing entity to use them towards their nationally determined contributions (NDCs) or for other mitigation purposes. Article 6.4 will enable project developers to register their carbon reductions and removals projects under a new UNFCCC project programme (commonly referred to as the "sustainable development mechanism") and sell tradeable carbon credits to public or private sector buyers.

However, nothing was agreed at COP28 on Article 6.2 or Article 6.4. "It was a disappointment, so now we have to look forward to COP29 in Azerbaijan in November 2024 or maybe even COP30 in Brazil in 2025 before we'll see full progress on these mechanisms," says Adam Hedley, a Clifford Chance Partner based in London. "Going into COP28, in theory it was about fine tuning Article 6(2) and answering some of the key questions that were still outstanding in relation to the early-stage deployment of that mechanism. Ultimately the Article 6 negotiations proved to be too contentious. There were too many issues still up in the air. The general consensus was that no deal was preferable to some kind of weak agreement which could compromise the integrity and rollout of Article 6."

One of the key issues around Article 6.2 was the role of the private sector; the failure of COP28 to agree on that has created some significant uncertainty as to whether private sector actors will have a role in trading, financing or consuming ITMOs in the future. "With regard to Article 6.4, corporate buyers aren't going to be able to buy credits from projects registered under that mechanism until some progress is made to put a framework in place. It's not going to happen anytime soon. We're talking some years down the line before we will see any credits in the market from the Article 6(4) mechanism," says Hedley.

Whilst progress on Article 6 was disappointing, COP28 proved to be something of a boon for the voluntary carbon market. Following a torrid year in which its credibility was seriously called into question, several senior figures at the COP (including the President of COP, US Special Presidential Envoy for Climate John Kerry and the World Bank President Ajay Banga) issued strong statements emphasising the importance of the voluntary market in achieving net zero. There were also a number of announcements made by the major VCM carbon standards and corporate standard setters, including the Integrity Council for the Voluntary Carbon Market (IC-VCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI), about increased collaboration in a bid to boost certainty and confidence in the voluntary market. "Whilst Article 6 is not yet really offering the private sector what it wanted for participation in the carbon market, the voluntary market may benefit and we may see some signals coming out of COP which will potentially see a resurgence of interest in the voluntary carbon market," says Hedley. The surge in carbon credit retirements at the 2023 suggests that sentiment is beginning to filter through to corporates.

What about biodiversity?

The COP Presidency published a joint statement with China on Climate, Nature and People, as Hedley explains: "This was a call to arms to the whole of society, to coalesce their efforts and to come together in various kinds of mechanisms and structures, voluntary partnerships, initiatives and coalitions to seriously pursue biodiversity in parallel with climate objectives." The statement includes the need to scale finance and investments in climate and nature from a range of sectors, multilateral banks, funds and development agencies, but also from the private sector. "This sends a pretty strong signal to business, and the finance sector specifically, that there will be increased opportunities for nature-related investments aligned with climate-related investments and, more generally, that biodiversity is going to increasingly be at the forefront of the corporate agenda and has to be integrated in climate transition plans as far as possible," Hedley says.

Clifford Chance Partner Roger Leese adds: "Businesses also need to be aware of potential regulation around biodiversity, for example, the new and voluntary Taskforce on Nature-related Financial Disclosures (TNFD) may well inform new mandatory standards, as the TCFD has done in relation to climate change diclosure."

Negotiations on adaptation, loss and damage

Mitigating climate change and adapting and responding to its impact will require significant additional finance. The COP28 Global Stocktake says that adaptation finance "will have to be significantly scaled up" to help the most vulnerable countries which need up to US$387 billion a year to adapt to climate change. The Adaptation Fund, which was established in 2001 under the Kyoto Protocol to finance concrete adaptation plans mobilised more than US$192 million in new pledges at COP28 – well short of its goal of US$300 million for 2023.

Meanwhile, wealthy countries pledged US$700 million to the Loss and Damage Fund. "In context, this is the equivalent of less than 0.2% of the economic and non-economic losses developing countries are facing annually from climate change," says Senior Associate David Alfrey. The funds will be run under the auspices of the World Bank for the first four years but there are questions around their governance. "Are there going to be strings attached that would make these akin to loans or interest-bearing instruments? Are the committed funds additional to or part of the same commitments that are being made by countries – the UK, for example, has already called for its commitment to be a repackaging of a pre-existing and pre-allocated amount. Are there measures to ensure that the allocation of funds is done in a manner that is just? How much money is enough and what happens when the money runs out?", he says. And he adds: "We expect that there are going to be a number of legislative, policy and regulatory measures introduced globally which would allow for increased opportunities for the private sector to participate in the global transition, in particular participating in implementation of the adaptation and loss and damage initiatives."

Just transition

COP28 called for the move away from fossil fuels to be carried out in a just, orderly and equitable way and presents some risks for the private sector. For the first time, COP's Just Transition Work Programme includes references to labour rights and social protections. "The Global Stocktake calls for the rights of all workers and economic diversification to be taken into account and that this be contextualised with the national circumstances and contexts. Economic diversification means adopting policies in a manner that promotes sustainable development and the eradication of poverty. There's a general recognition from this language that there is currently a lack of knowledge and understanding of the impacts of the measures that are currently being implemented and the associated risks to people," says Alfrey.

The Global Stocktake includes a call for case studies on Just Transition and the private sector can participate on an annual basis. "It would be safe for the private sector to assume that in respect of Just Transition we will see an increase in policies and direction for ensuring that assessments and impacts, both from the supply chain to people and from a consumption and supply perspective, are being considered," he says.

How will these high-level agreements filter through to policy, law and regulations?

The agreements at COP28 are not in themselves legally binding. However, following COP, countries are likely to look at their Nationally Determined Contribution (NDC) commitments, their domestic policy agendas and frameworks and to drive through what they interpret as being the commitments that they have made in order to limit global warming to 1.5°C. "Another thing to watch for is which countries championed which agenda in COP28 discussions and negotiations. For example, the Buildings Breakthrough, which aims to make climate-resilient buildings the new normal by 2030, was championed heavily by the French government, so I would expect France to not only push heavily on that in its own jurisdiction, but also to try and be an advocate of that at an EU level too," says Kumar Iyer, Senior Economic and Strategy Advisor at Clifford Chance.

And he adds: "Non-state activism and non-state players will become increasingly important – we are already seeing an increasing number of civil suits that take local national legislation and local rules to force compliance in a number of areas."

A historic number of elections will take place in 2024 with around 2 billion people having the chance to vote. Decisions taken at COP28 are likely to interact with trade policy, national security, geopolitics and development issues in many of those elections.

Iyer says that policymakers are thinking in the medium term about the companies that are not fully committed to the climate agenda and how to get them on board through tougher taxes and stricter compliance requirements. "What does that mean for businesses? In order to be ready for those mechanisms, it's about having the right reporting, compliance and data systems in place. Due diligence around the risk will continue to be important – in particular from the litigation angle," he says.

To find out more, watch our webinar on COP28: What it means for businesses **here**.

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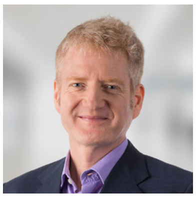

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